PHILLIPS PETROLEUM COMPANY • ANNUAL REPORT 1987

Corporate Profile

Phillips is headquartered in Bartlesville, Okla., where the company was founded in 1917. Bartlesville is located in the northeastern part of Oklahoma, some 50 miles north of Tulsa.

Phillips is engaged in these businesses:

- Petroleum exploration and production on a worldwide scale.
- Petroleum refining and marketing in the United States.
- Chemicals production and distribution worldwide.

The company's activities are organized into the following groups, whose operations are discussed in this report:

- Exploration and Production
- Gas and Gas Liquids
- Petroleum Products
- Chemicals

At the end of 1987, Phillips employed 22,500 people, had 100,078 common stockholders and assets of $12.1 billion. The company's products and processes were licensed in 41 countries.

About The Cover

Early morning fog envelopes Ekofisk Center as workers prepare for one of the largest jacking operations in history—the elevation of six platforms by some 20 feet. It was discovered in late 1984 that the Ekofisk field, located in the Norwegian North Sea, had subsided by 12 feet, thereby reducing the tolerance of the platforms to withstand extreme weather conditions. In July the company elevated a 10,000-ton hotel platform, and in August lifted five other platforms weighing more than 30,000 tons. In 1988 Phillips will begin constructing a circular concrete barrier around the one-million-barrel storage tank, seen in the background, which was not elevated.

Contents

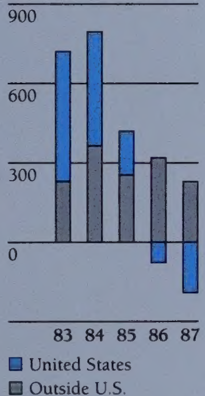
Highlights

	Millions of Dollars Except as Indicated		
	1987	1986*	1985*
Financial			
Total revenues	$10,917	10,018	15,840
Net income	$ 35	228	418
Net income from each dollar of revenue	.3¢	2.3	2.6
Net income per share of common stock	$ .06	.89	1.44
Interest expense	$ 729	685	846
Total taxes charged to income	$ 448	656	1,625
Capital expenditures	$ 750	660	1,088
Total assets at year-end	$12,111	12,403	14,052
Dividends paid On common stock	$ 137	159	542
On preferred stock	$ 19	24	12
Cash dividends per share Common stock	$ .60	.70	.95
Preferred stock	$ 1.73	2.02	1.04
Average common shares outstanding (in thousands)	228,326	227,546	278,916

**Restated—see Note 1 of the Notes to Financial Statements.*

	Thousands of Barrels Daily		
Operating			
Crude oil produced United States	113	124	154
Outside United States	105	114	127
Natural gas liquids produced	182	202	204
Total liquids produced	400	440	485
Crude oil refined	302	301	292
Petroleum products sold	555	554	575
	Millions of Cubic Feet Daily		
Natural gas produced	1,086	1,120	1,306

Net Income
(Millions of Dollars)



"Phillips," "the company," "we" and "our" are used interchangeably in this report to refer to the business of Phillips Petroleum Company and its consolidated subsidiaries. Where reference is made to a particular company, it is wholly owned unless otherwise stated. The company's consolidation policy is to include in financial statements the accounts of companies in which more than 50-percent interest is held, except for an insurance company and a credit company.

Phillips 66, Driscopipe, K-Resin, Marlex, Ryton and SuperClean are trademarks for the company's products named in this report.

C.J. Silas

To The Owners:

Like you, we were disappointed with our 1987 earnings. A modest upturn in oil prices helped us somewhat during the year, and our chemicals business had its best year ever. But these positive developments were outweighed by much lower profit margins in our refining and marketing operations and by the decline in the U.S. dollar, which caused substantial currency transaction losses. We also took some cost-saving steps during the year that resulted in a one-time profit reduction. As a result, net income for the year dropped to $35 million, or 6 cents a common share, compared with net income of $228 million, or 89 cents a common share, in 1986, when we benefited from gains from sales of assets and the restructuring of our pension plan.

While external factors like the price of oil and the value of the dollar have a big effect on our performance, we don't offer them as excuses for why we aren't doing better. It's our job to cope with the circumstances we face and find ways to achieve more satisfactory results. We anticipate that oil prices will improve slowly and erratically and probably will remain in the $15 to $20 range for the next year or two. The outlook for natural gas prices is somewhat more optimistic, but sustained improvement is unlikely before 1989. In view of these market conditions, we know that further significant changes in company operations are essential to achieve better earnings performance in 1988, and we are making those changes.

Improving Profitability

At the beginning of 1988, we began a major new program designed to lower costs, improve the efficiency of our exploration effort and increase capital investment in areas of our business that have good potential even in an environment of flat or slowly rising oil prices.

Most of the cost-reduction steps involved in this program are well under way and will have an impact on 1988 results. These measures, including a further reduction in the size of our work force, are expected to result in annual pretax savings of $150 million to $200 million.

As part of this program, we are carrying out a major reorganization of our upstream operations, those businesses that are responsible for finding and producing oil and natural gas and for extracting the liquids from natural gas. This reorganization will enable us to lower our overhead, streamline procedures and accelerate decision-making. Our objective is to make these operations profitable even under adverse market conditions.

The changes we are making will help us gain maximum impact from our 1988 capital investment program, which has been increased approximately 10 percent above 1987 spending. More than a third of the $825 million we have budgeted will be directed toward projects in our petroleum products, chemicals and plastics businesses, where profits have been strong. Our upstream expenditures will be oriented toward maintaining our production of oil

and gas and carrying out an active but somewhat smaller exploration program.

Reaching Goals
Throughout 1987, despite the difficulties presented by the oil and gas market, Phillips achieved important objectives.

We met our debt reduction target for the year, bringing our total debt down to $5.6 billion. Our longer term objective is to reduce debt and build our equity base enough to regain our investment-grade bond rating, which will allow the restructuring of debt under more favorable terms. Cash flow remained strong throughout 1987.

We also carried out a major engineering project in the Norwegian North Sea during 1987, raising six offshore platforms higher above the water to compensate for subsidence of the ocean floor at our Ekofisk field. This complex technological and logistical operation was completed with an unprecedented degree of safety and with minimum lost production time.

A complete review of company operations during 1987 begins on page 6. However, we would like to emphasize several key developments that illustrate the potential we see in our major businesses.

• In chemicals, we achieved record operating profits in 1987 after strong performances in each of the two previous years. Demand was particularly strong for our plastics, and we are expanding production of some of our most profitable products. Our success in this area is based in part on the natural gas liquids feedstocks we receive from our refineries and natural gas plants. Phillips is the nation's leading producer of natural gas liquids, which are an ideal, low-cost feedstock for our chemicals and plastics. In addition, we have highly efficient processing facilities and an excellent mix of competitive products, most developed in our own research laboratories.

• Although profitability declined because of higher raw material costs, our refineries continued to operate at capacity rates far above the industry average, and we increased our share of the U.S. motor fuel market for the fourth straight year. Late in 1987, we began withdrawing from four eastern states in order to concentrate on markets more efficient to the company. We've been making steady progress in our effort to increase the average sales volume of our retail stations and reduce operating expenses per gallon of product sold. During the year, we introduced a new medium-octane motor fuel, SuperClean® Unleaded Plus, to go along with our lower and higher octane unleaded fuels.

• In our exploration and production operations, we replaced, on a barrel-of-oil-equivalent basis, more than 100 percent of the oil, natural gas and natural gas liquids reserves we produced during the year. Oil and natural gas liquids production declined during the year, but natural gas production remained essentially unchanged. During the year, we began at Ekofisk the

Glenn A. Cox

largest enhanced oil recovery program we have ever undertaken. Through this waterflood project, we expect to prolong the productive life of the Ekofisk field and recover the equivalent of an additional 140 million to 170 million gross barrels of oil.

- Our coal company reached an agreement in 1987 to supply lignite to an electric generation plant being built in east-central Texas by Texas-New Mexico Power Company. Under this agreement, Phillips will supply up to 3.3 million tons of lignite a year for 38 years. Deliveries are expected to begin in late 1989.

Looking Forward

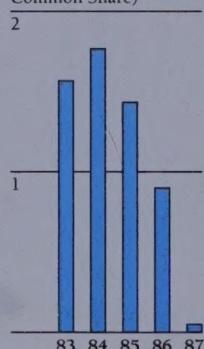
Given the uncertain outlook for oil and natural gas prices, we believe the best strategy in the upstream arm of our business is to concentrate on the development of existing oil and gas discoveries that can contribute most quickly to an improvement in earnings. Exploration for new reserves is essential, but we will remain focused on acreage acquisitions and activities located primarily in mature, producing areas and engage in higher risk, frontier projects only when we have a special advantage.

Our ability to lower costs will be a major factor in the success of our gas and gas liquids business. Because of the gains we've made in this area and our position as an industry production leader, we have the potential for significantly higher profits even with modest price improvements in natural gas liquids. A continuing strategic objective in this part of our business is to increase the amount of natural gas we sell directly to consumers.

In our refining and chemicals operations, we intend to make the capital improvements necessary to generate more high-value products from a given barrel of feedstock. We will continue our vigorous program to improve service for customers at Phillips 66® service stations throughout our 28-state primary marketing territory. As part of this effort, we are building more modern stations in high-traffic areas and working to build greater customer appeal.

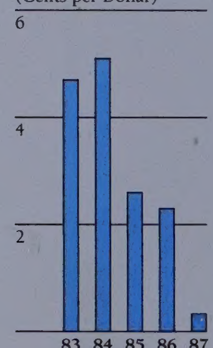
Another critical factor in improving our profitability is the degree to which we can utilize advanced technology, both in our

Net Income Per Share*
(Dollars per Common Share)



**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Profit From Each Dollar of Revenue
(Cents per Dollar)



existing businesses and in developing new commercial products. As an example, a hazardous waste incinerator we developed at our Research and Development Center is now being marketed commercially by a joint-venture corporation established by subsidiaries of Phillips and another company. During the year, we also brought a new advanced composite material with aerospace applications to the commercial stage and made significant progress in the development of a new plastic.

Renewing Our Commitment

The uncertainty that shadows our industry's outlook does not obscure our basic company objective—to generate a competitive and consistent return on the investment of our shareholders. This goal has been clearly in mind as we have adjusted our business operations to meet today's vastly different market environment. And this goal remains clear as we continue our efforts to:

- Improve profitability;
- Meet the highest standards of quality and value in the products we sell;
- Make our company a safe, challenging and rewarding place to work;
- Conduct all of our operations in an ethical and responsible manner;
- And do all we can to build public support for the oil and gas development activity so essential for our nation's security and economic health.

We appreciate your continuing confidence and support.

For the Board of Directors,

C.J. Silas
Chairman and Chief Executive Officer

Glenn A. Cox
President and Chief Operating Officer

March 11, 1988

Exploration and Production

Exploration and Production continued to adapt to volatile energy markets and depressed petroleum prices. Although Phillips average price of crude oil rose almost $3 during the year, to $17 a barrel, it remained far below the $26 average of 1985, before the Organization of Petroleum Exporting Countries began producing more oil and driving down prices. Equally significant for Phillips were depressed natural gas prices, which only began to strengthen in the fourth quarter of the year. Natural gas is important to Phillips since it accounts for about 30 percent of the company's total hydrocarbon production.

Despite low prices, Exploration and Production accomplished a key objective during the year by replacing on a barrel-of-oil-equivalent basis all the hydrocarbon reserves it produced in 1987. Revisions of existing reserves accounted for a large part of the reserve replacement, but discoveries of new reserves and extensions of existing reserves also contributed.

During the year, the company made oil and natural gas discoveries in six states and five foreign countries.

Profitability Up for Year
Operating profit for Exploration and Production was $381 million in 1987, compared with $255 million in 1986. Although crude oil prices strengthened during the year, this business continued to be affected by lower crude oil production. Profitability also was negatively impacted by lower natural gas prices.

In 1988 Phillips plans to devote about 45 percent, or some $375 million, of its total capital expenditures budget to Exploration and Production. Major expenditures will be directed to development programs already under way offshore Southern California and in the Gulf of Mexico. Overseas, expenditures will be made to increase recovery from the Ekofisk field in the Norwegian North Sea and to develop discoveries in the U.K. North Sea and offshore Indonesia.

Strengths: Secure Sources for Production, Reserves
A major strength of Exploration and Production is that its production and reserves are in the more secure areas of the world. In 1987 the United States accounted for 52 percent of the company's worldwide crude oil production and 71 percent of its natural gas production. In addition, the United States held almost half of Phillips crude oil reserves in 1987 and more than 60 percent of its natural gas reserves.

Norway, the United Kingdom, Canada and Nigeria accounted for most of the remainder of the company's oil and natural gas production and reserves.

Crude Prices Rise
Phillips average price for U.S. crude oil was $16.35 a barrel, up 18 percent from 1986. Outside the United States, prices averaged $17.69 a barrel, up 23 percent. Natural gas prices continued to be depressed, falling 12 percent in the United States and 28 percent elsewhere.

Phillips Replaces Reserves
On a barrel-of-oil-equivalent basis, total reserves were up slightly for the year. Estimated worldwide proved reserves of crude oil increased to 744 million barrels, up 4 percent from 1986. Proved reserves of natural gas liquids declined 11 percent to 165 million barrels, and worldwide proved reserves of natural gas rose 3 percent to 5.29 trillion cubic feet.

Crude Oil Production Down, Natural Gas Holds Steady
Crude oil production was 8 percent lower than in 1986. Three major factors contributed to the decline: the sale in 1986 of selected producing properties, the normal decline that occurs in fields as they mature and government-mandated curtailments in Norway and Nigeria. Because of development projects currently under way or planned, the company expects to be able to hold crude production near the 1987 level for the next two to three years. This assumes no additional government-mandated curtailments in production.

Because of discoveries and current development projects, the company also expects to maintain natural gas production near the 1987 level for the next two to three years. This assumes stable market conditions and no major changes in government regulations or additional government curtailments. In 1987 natural gas production was essentially unchanged from the previous year.

Strategy: Develop Discoveries for Early Cash Flow; Hold Levels for Production, Reserves

For the short term, a key strategy of Exploration and Production is to develop existing discoveries that can be brought on stream quickly to generate early cash flow and that can help hold production and reserves at relatively stable levels for the next two to three years.

• *California:* One of the earliest additions to crude oil production will come from the company's Point Arguello field in the Santa Maria Basin offshore Southern California. Initial production is expected to begin early in the second quarter of 1988 and reach a rate of 15,000 net barrels a day by 1989. Natural gas production is expected to reach an average rate of 21 million net cubic feet a day in 1993. At the end of the year, two production platforms were in place, and onshore processing facilities at Gaviota were nearing completion. Phillips has interests ranging from 40 to 50 percent in four blocks in the Point Arguello field.

• *Gulf of Mexico:* By mid-1988, Phillips plans to begin producing natural gas from two fields offshore Louisiana. One field, in which Phillips has a 29-percent interest, is expected to produce at a rate of 12 million net cubic feet a day. Initial production from the second field,

A new water-injection platform, at left, went into operation late in the year at the Ekofisk field in the Norwegian North Sea. The waterflood, the largest in Phillips history, is expected to recover the equivalent of 140 million to 170 million gross barrels of oil over the life of the field.

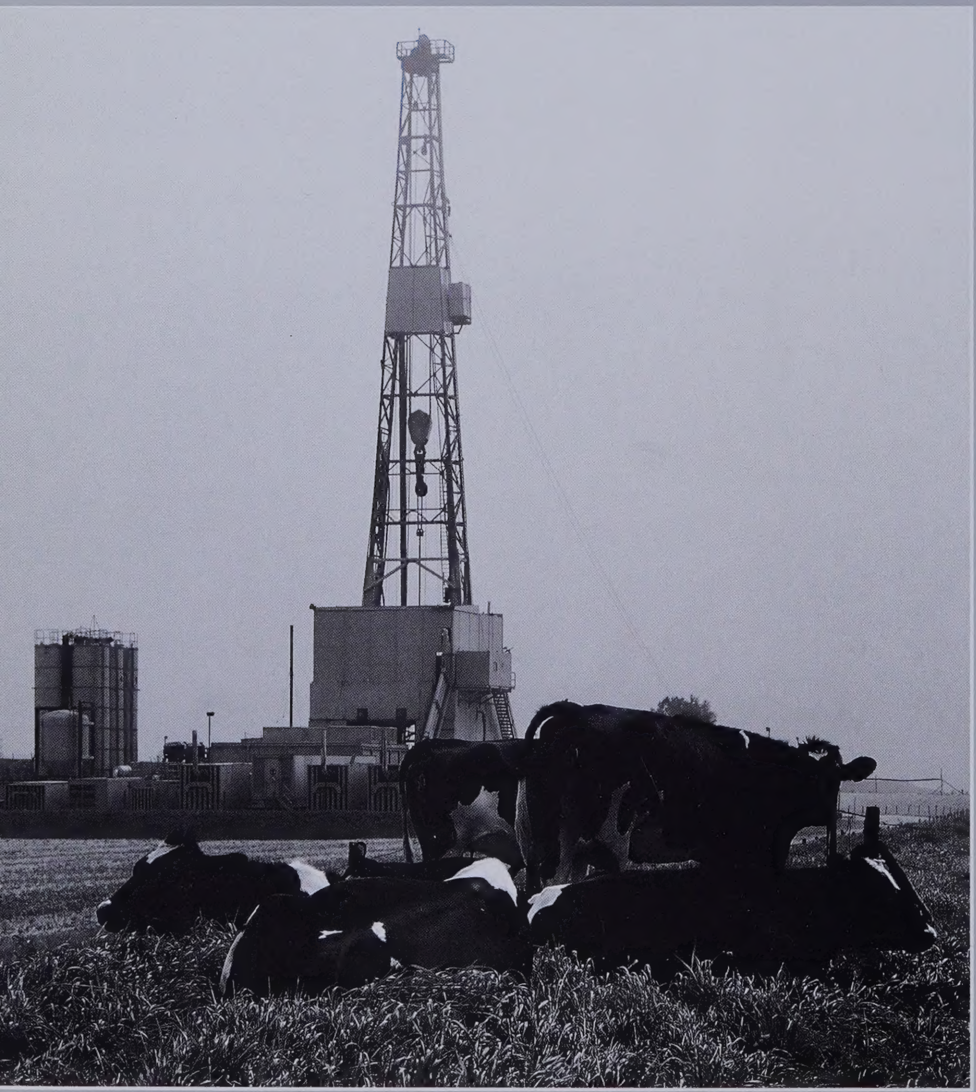
During the year, the company drilled a successful exploratory well in a rural area of the Netherlands. The Netherlands is one of several countries where Phillips has acquired acreage recently and is exploring for oil.

owned 17 percent by Phillips, is expected to be 8 million net cubic feet a day.

The company also continued a vigorous development program in the Gulf. During the year, Phillips participated in 13 development wells, 10 of which were successful.

• *United Kingdom:* A number of steps were taken during the year to improve the company's gas position off the southeast coast of Great Britain. A $45 million development program was completed that will increase ultimate gas recovery from the Hewett-area fields by 50 billion gross cubic feet. Within the next two years, production will benefit further from a successful natural gas well that was drilled nearby and that will be tied into the Hewett platform. Phillips has a 19-percent interest in the Hewett-area fields.

The company also is moving ahead with the development of the Audrey natural gas field, located just north of Hewett. Deliveries to the British Gas Corporation are expected to begin in 1988. Phillips is the operator and has a 23-percent interest.



• *Alaska:* In September, Phillips share of production from the Prudhoe Bay field increased by some 10,000 barrels of crude oil a day as a result of completing an equity redetermination payback. This brings Phillips total share of production from that field to approximately 25,000 barrels a day.

• *Indonesia:* By 1990 the company expects to begin producing crude oil from a second field in the Kakap block offshore Indonesia. Phillips share of production from the two fields is expected to reach 4,200 barrels a day in 1991.

• *Mature Basins:* The company also is developing a number of oil discoveries in the more mature areas of the United States, where the risks are low and where there is good potential for adding to production. In Texas, for example, Phillips participated in 10 oil discoveries in the Hardeman, Hugoton and Permian basins. Other oil discoveries were made in Wyoming's Powder River Basin and the Chatom area of southwest Alabama. The company also has an extensive development program under way in Oklahoma's Golden Trend, where 16 oil wells were completed during the year.

• *Enhanced Recovery:* The largest enhanced oil recovery project in Phillips history began late in 1987, when the company started injecting water into its Ekofisk field in the Norwegian North Sea. The waterflood is expected to increase recovery by approximately 140 million to 170 million gross barrels of oil equivalent over the life of the field. Phillips is the operator and has a 37-percent interest.

Another 367 secondary and tertiary enhanced oil recovery projects were in progress at the end of the year to maintain production levels from existing U.S. fields. These projects account for about one-third of Phillips total U.S. crude oil production.

Strategy: Vigorously Appraise Future Development Prospects

In addition to discoveries now being developed, the company is evaluating other promising prospects that could add to production and reserves some five years or so into the future.

• *California:* At the end of the year, a fourth appraisal well was under way to evaluate further the extent of the Rocky Point field, located two miles north of the Point Arguello field. Phillips has a 44-percent interest in the well.

• *United Kingdom:* In 1987 the company completed a 3-D seismic survey of the J-Block, located in the U.K. North Sea. The company has drilled seven successful oil wells on the structure. Phillips is the operator and has a 33-percent interest.

Late in the year, the company drilled successful natural gas wells on two prospects near its Audrey natural gas field. Additional drilling is planned in order to assess other prospects in the area. Phillips is operator and has a 23-percent interest.

Strategy: Explore Where Potential Is Good for Making Major Reserve Additions

Phillips continues to acquire acreage in areas of the world where it believes there is good potential for making major additions to oil and natural gas reserves.

• *Gulf of Mexico:* The Gulf continues to be an active exploration area for Phillips. At two federal lease sales during the year, the company was successful bidder for 14 tracts offshore Texas and Louisiana, with interests ranging from 20 to 50 percent. The company plans to participate in 14 exploratory wells in these waters during 1988.

• *Alaska:* Phillips acquired six tracts in the Camden Bay area, immediately offshore the Arctic National Wildlife Refuge (ANWR), one of the most promising areas of Alaska remaining to be explored. At the end of the year, the company was participating in an industry test well located four miles northeast of the ANWR coastline.

• *United Kingdom:* Phillips acquired a 37-percent interest in a license offshore the United Kingdom and was named operator of the four-company group that will explore it. The license is on blocks bordering the company's Maureen field. The company plans to drill its first exploratory well in 1988.

• *Egypt:* Phillips acquired a major interest in 1.5 million acres in Egypt's Western Desert, adjacent to the company's Umbarka field. A well is planned in 1988.

• *Other Areas:* During the year, the company enhanced its acreage overseas by agreeing to acquire interests in Pakistan, Gabon, Italy and Somalia. A successful exploratory well was drilled in the Netherlands on acreage acquired the previous year. Additional drilling is planned in the Netherlands in 1988, as well as in Pakistan and Gabon.

Phillips Produces in Nine Countries in 1987

During the year, Phillips production came from eight countries, in addition to the United States. An overview of each country's contribution follows.

• *United States:* In 1987 production averaged 112,900 barrels of oil a day, down 9 percent from a year earlier. Natural gas production was down 6 percent, averaging 772 million cubic feet a day. Phillips completed, or participated in the completion of, 509 exploratory and development wells, a 2-percent decrease from 1986. Capital expenditures were $220 million, up 3 percent from 1986. Exploration expenses totaled $294 million, down 8 percent from a year earlier.

• *Norway:* Crude oil production was lower from the Greater Ekofisk Development in the Norwegian North Sea, primarily the result of the natural decline that occurs as fields mature, as well as by a government mandate to curtail production by 7.5 percent. The company's 37-percent share of production averaged 46,000 barrels of crude oil a day, down 12 percent from 1986. Natural gas liquids

production was down 17 percent, averaging 8,100 barrels a day.

Natural gas production was up 11 percent over the previous year, averaging 241 million cubic feet a day. In 1986 natural gas production was curtailed by a gas-reinjection program that was under way most of that year to reduce the rate of subsidence in one of the seven fields that make up Greater Ekofisk. It was discovered in late 1984 that the Ekofisk field had subsided some 12 feet, thereby reducing the tolerance of the platforms there to withstand extreme weather conditions.

The gas-reinjection program was discontinued when the company decided on an alternate plan to alleviate the subsidence problem—the elevation of the six platforms on the field by 20 feet.

The successful jacking operation, one of the largest in history, involved elevating a 10,000-ton hotel platform in July and the elevation of five production platforms, weighing more than 30,000 tons, in August. In 1988 the company will begin constructing a circular concrete barrier around the one-million-barrel oil storage tank, which also had subsided but was not elevated.

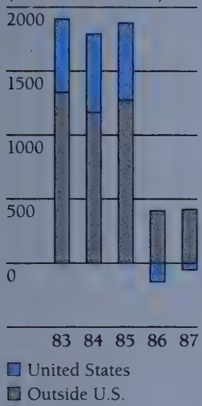
- *United Kingdom:* Phillips 34-percent share of production from the Maureen field in the U.K. North Sea averaged 21,800 barrels of crude oil a day in 1987, a 3-percent decrease from a year earlier. In 1987 Phillips 19-percent share of natural gas production from the Hewett-area fields averaged 43 million cubic feet a day, compared with 54 million cubic feet a day in 1986.
- *Nigeria:* Government-mandated curtailments reduced Phillips share of production to 19,300 barrels of oil a day, compared with 21,800 barrels a day in 1986. Three development wells were drilled during the year and a second gas-reinjection program was begun to maintain production levels.
- *Other Producing Areas:* Phillips share of production from Cote d'Ivoire averaged 4,400 barrels of oil a day, down 10 percent from 1986. Production from Canada averaged 5,000 barrels of oil a day, up 27 percent from the previous year, and 30 million cubic feet of natural gas a day, a 3-percent increase.

Crude oil production from Egypt was 2,000 barrels of oil a day, compared with 2,100 barrels a day in 1986. In Indonesia, production was 2,100 barrels a day, compared with 1,600 barrels a day in 1986. Net production from Argentina was 4,600 barrels of oil a day, compared with 4,900 barrels a day the previous year.

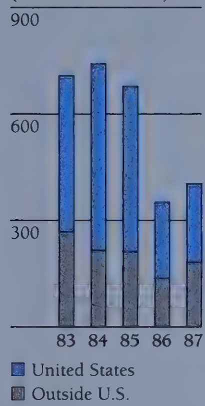
Steel towers loom over the deck of this production platform at the company's Point Arguello field in California's Santa Maria Basin. Initial production is scheduled to begin in the second quarter of 1988.

Exploration and Production Statistics

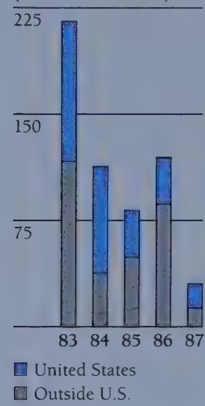
Operating Profit
(Millions of Dollars)



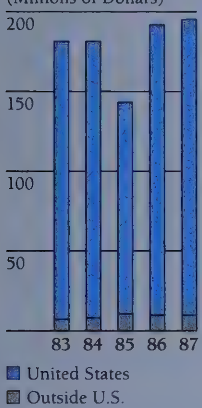
Capital Expenditures
(Millions of Dollars)



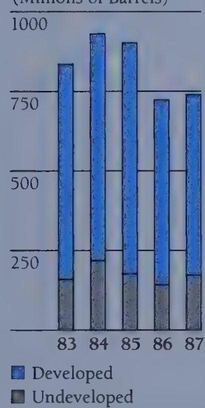
Dry Hole Costs
(Millions of Dollars)



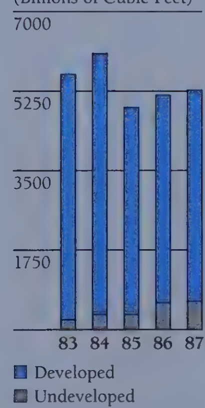
Leasehold Impairment
(Millions of Dollars)



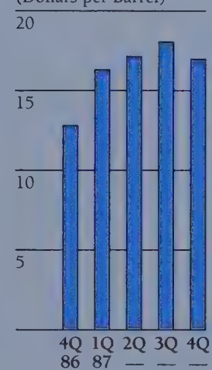
Worldwide Proved Crude Oil Reserves
(Millions of Barrels)



Worldwide Proved Natural Gas Reserves
(Billions of Cubic Feet)



Average Worldwide Quarterly Crude Oil Price
(Dollars per Barrel)



Gas and Gas Liquids

Gas and Gas Liquids is an important business for Phillips, both from its contribution to net income and from the secure feedstock it provides in the form of natural gas liquids to the company's downstream operations of Petroleum Products and Chemicals.

Natural Gas Liquids Prices Continue to Affect Profitability

Operating profit for Gas and Gas Liquids was $39 million in 1987, compared with a loss of $8 million a year earlier. Profits improved primarily because of moderately higher prices for natural gas liquids and liquefied natural gas and because of greater operating efficiencies. Although natural gas liquids prices were up for the year, they continued to be held down by imports and high inventories built up industrywide in 1986.

In 1987 the company processed 1.9 billion net cubic feet of natural gas a day, compared with 2.0 billion net cubic feet a day in 1986.

In 1988 Phillips will devote 8 percent of its total capital expenditures budget to Gas and Gas Liquids, about the same as the previous year. Major expenditures will go to connect new supplies of natural gas to the company's gathering and processing systems.

Strengths: Extensive Reserves, Strategically Located Systems

The major competitive strengths of Gas and Gas Liquids are its extensive natural gas supplies, its well-situated gathering systems and efficient processing facilities located in prime, gas-prone areas of the country.

Phillips Leading Natural Gas Liquids Producer in U.S.

In 1987 Phillips continued to be the country's largest producer of natural gas liquids, with production of 174,000 barrels a day. This was down some 17,600 barrels a day from 1986. Production was impacted by an industrywide decline in drilling activity and by lower ethane prices, which prompted Phillips to reduce ethane production.

Residue gas sales were 1.04 billion cubic feet a day, compared with 1.01 billion cubic feet a day in 1986. Phillips share of liquefied natural gas sales from a plant in Kenai, Alaska, was 93 million cubic feet a day, compared with 96 million cubic feet a day in 1986.

Supplies of Natural Gas Lower for Year

In addition to natural gas from its own exploration and production program, Phillips has access in the United States to extensive supplies of natural gas and natural gas liquids through purchase contracts and processing or exchange agreements. At the end of the year, natural gas available through contracts and agreements totaled 2.37 trillion cubic feet, compared with 2.63 trillion cubic feet at the end of 1986. Natural gas liquids available under purchase contracts and processing agreements were an estimated 296 million barrels at the end of 1987, compared with 330 million barrels the previous year.

Strategy: Strengthen Direct Marketing Effort

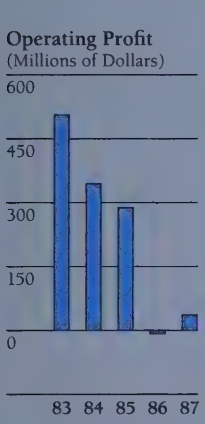
Phillips is taking steps to improve its gas marketing position, especially in the area of direct sales. Part of this effort includes transporting commodity gas through two pipeline systems, which extend from central Oklahoma to the Texas Gulf Coast.

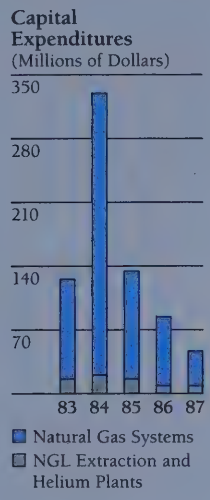
The company also is entering into contracts directly with end-users. For example, early in 1988, Phillips signed an agreement with the city of Garland, Texas, to supply that community with natural gas. At the end of 1987, about 30 percent of Phillips natural gas sales were made directly to local distributing companies and end-user markets.

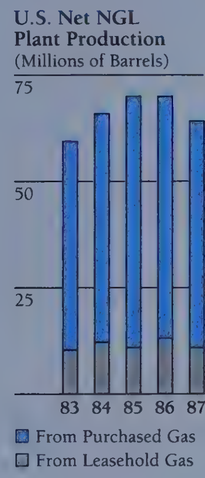
Strategy: Lower Operating Costs

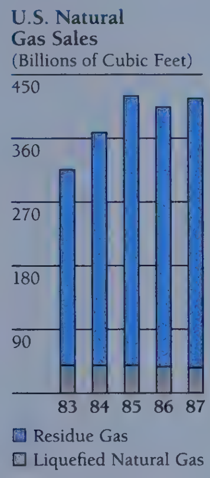
To achieve greater operating efficiencies, the company closely monitors its gathering and processing facilities and, when necessary, rechannels gas from uneconomic plants to other plants. As a result of this effort, two plants were shut down in 1987 without significant loss of natural gas or natural gas liquids production. At the end of the year, Phillips owned or partly owned 50 natural gas liquids extraction plants in the United States, most of them strategically located in key producing areas of the country.

Gas and Gas Liquids Statistics









Tracy Elm, division order analyst, uses a computer to track key information about the company's Gas and Gas Liquids operations. Personal workstations are just one method being used to increase overall efficiencies.

Petroleum Products

Although 1987 was not as profitable as 1986, Petroleum Products had some significant accomplishments for the year: Refining operations were near the top of the industry for safety; Phillips refineries ran far above the industry's average utilization rate; and the Phillips shield rose high above some of the most modern and convenient service stations in the country.

Lower Margins Drive Down Operating Profit

Operating profit for Petroleum Products was $201 million in 1987, compared with $458 million a year earlier. Although prices were up, this business was impacted by higher feedstock costs that could not be fully recovered in the marketplace.

In 1988 about 20 percent of the company's total capital expenditure budget will go to Petroleum Products. Major expenditures will be directed toward retail marketing, refinery improvements and the construction of a hazardous waste incinerator at the company's Sweeny, Texas, refinery.

Strengths: Secure Feedstocks, Sophisticated Refining System

A major strength of Petroleum Products comes from Phillips being a fully integrated company with access to a secure supply of feedstocks. For example, Gas and Gas Liquids provides the natural gas liquids that are used in the company's downstream operations.

Another strength is the company's state-of-the-art refining system, which can process lower cost crude oils into high-value products. Also, because the company sells more gasoline than it refines, it can operate its refineries near 100 percent of rated capacity, which helps lower per unit processing costs.

Product Sales Remain Strong

Motor fuel sales volumes were up for the fourth consecutive year, reflecting Phillips aggressive effort to market more of its Phillips 66® brand products. Compared with 1986, sales volumes of branded products were up 3 percent to the company's independent marketers, while volumes rose 36 percent from Phillips own retail outlets. U.S. sales volumes of distillates improved slightly during the year.

U.S. sales volumes of natural gas liquids products were down 13 percent from 1986, primarily due to weak demand and lower supply availability.

Crude Runs Up for Year

Overall, crude runs were up slightly for the year. U.S. crude oil accounted for 77 percent of the company's crude runs, down 4 percent from the previous year. Natural gas liquids processed in Phillips facilities were down for the year.

Refineries Operate Above Industry Average

Phillips operated its three U.S. refineries near 100 percent of rated capacity, compared with an industry average of 83 percent.

The cost of crude oil delivered to its refineries was 24 percent higher in 1987, primarily the result of strengthening crude prices. High-sulfur crude oil, a low-cost grade of crude from which Phillips produces high-value products, accounted for 66 percent of the crude processed, about the same as the previous year.

The cost of natural gas liquids was up slightly for the year. The company processed an average of 195,000 barrels of natural gas liquids a day, down 3 percent from the previous year.

Phillips 66® Brand Continues to Shine for Motorists

Travelers on Oklahoma's Turner Turnpike, which connects Tulsa and Oklahoma City, now are experiencing the latest in Phillips station design and service. In a program with McDonald's Corporation, three combined Phillips and McDonald's facilities are serving customers on the 90-mile route. Early in 1988, the two companies joined together to serve travelers on the Will Rogers Turnpike, as well.

An aggressive program to enhance the image of the Phillips 66® brand continued in 1987, as Phillips worked with its independent marketers to improve

A new HF alkylation unit will be constructed here at the Sweeny, Texas, refinery in 1988. The unit will enable the company to produce more high-octane blend stocks.

service and appearance at retail outlets. The company also took steps to make its brand more visible by building or renovating 49 Phillips-owned stations, many of them in high-traffic areas.

A vigorous credit card solicitation program, initiated in mid-1987, increased Phillips customer base by almost 200,000 accounts.

During the year, Phillips introduced a medium-octane unleaded gasoline under its SuperClean® trademark. The company also markets regular and high-octane SuperClean® gasolines. All have high detergent content to keep fuel-injectors and carburetors running clean.

Strategy: Produce More High-Value Products, Control Costs

In order to enhance its position in the marketplace, the company is making capital improvements to its refining system that will enable it to produce more high-value products. For example, in 1988 construction will begin on a new HF alkylation unit at the Sweeny refinery, which will allow Phillips to process a higher volume of low-value by-products into higher octane blend stocks. At the same time, the new unit will let the company sell aromatics as higher value petrochemical products, rather than using them for gasoline blending.

Because the disposal of waste materials is increasingly costly, Phillips is building a hazardous waste incinerator at the Sweeny refinery and plans to build a similar incinerator at the Borger, Texas, refinery.

Strategy: Increase Sales of Phillips 66® Brand Products

In today's highly competitive environment, Phillips is working to expand its retail effort by building modern stations in prime, high-traffic areas. Part of this effort includes joining with other major corporations to create greater appeal and a broader range of customer services.

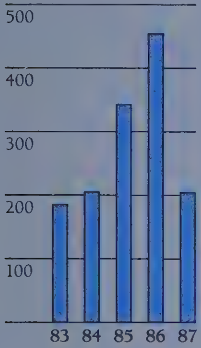
Efforts are also under way to strengthen Phillips presence in key marketing areas. During the year, the company began withdrawing from four states, enabling it to concentrate on markets more efficiently served by its refining and distribution network.

Phillips continues to be an industry leader in offering innovative programs that encourage its marketers to rebuild or upgrade their retail outlets. At company-owned outlets, average sales volumes are up, and operating expenses are down.

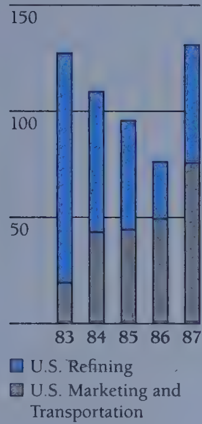
Travelers on Oklahoma's Turner Turnpike are greeted by the Phillips 66® shield and the golden arches of McDonald's. To strengthen its retail marketing effort, the company is joining with other major corporations to create greater appeal and a broader range of customer services.

Petroleum Products Statistics

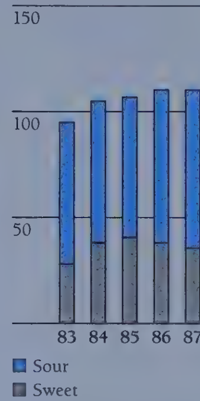
Operating Profit
(Millions of Dollars)



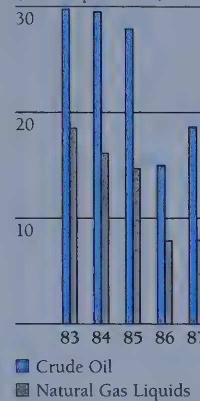
Capital Expenditures
(Millions of Dollars)



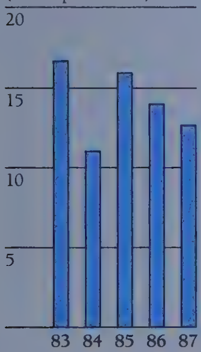
Refinery Crude Oil Runs
(Millions of Barrels)



Average Cost of Refinery Feedstocks
(Dollars per Barrel)



Margin of Motor Fuel Sales Price Over Crude Oil Feedstock Cost
(Cents per Gallon)



Refinery Crude Oil and Natural Gas Liquids Capacities and Runs—Thousands of Barrels Daily

	Crude Oil		Natural Gas Liquids	
	Capacity	Runs	Capacity	Processed
1987				
Sweeny, Texas	**175**	**176**	**86**	**88**
Borger, Texas	**105**	**102**	**95**	**79**
Woods Cross, Utah	**25**	**24**	**—**	**—**
Conway, Kansas	**—**	**—**	**42**	**28**
	305	**302**	**223**	**195**
1986				
Sweeny, Texas	175	175	86	89
Borger, Texas	100	103	95	86
Woods Cross, Utah	25	23	—	—
Conway, Kansas	—	—	42	26
	300	301	223	201

Major Products Produced Per Barrel of Crude Runs

	1987	1986
Automotive gasoline	**61%**	63
Aviation fuels	**12**	14
Distillates	**30**	28
Residual products	**1**	1

Phillips blends natural gas liquids into automotive gasoline, which enables the company to have one of the highest percentages of gasoline produced per barrel of crude oil runs.

Chemicals

Chemicals had its best year ever in 1987 with operating profit of $482 million, compared with $299 million in 1986. The increase was the result of higher sales volumes and margins, especially for olefins and plastic resins.

In 1988 Phillips will direct approximately 15 percent of its total capital expenditures budget to Chemicals, compared with 10 percent the previous year. Major expenditures will be made to increase manufacturing capacities for ethylene, plastics and fibers.

Strengths: Secure Feedstock, Sound Research

Several important factors work together to make Chemicals competitively strong. First, this business greatly increases the value of natural gas liquids feedstock transferred from the company's Petroleum Products and Gas and Gas Liquids operations. And second, Chemicals is backed by a strong research and development team, which continues to develop new, specialized and higher value products, especially in the plastics arena.

Revenues Up for Ethylene, Other Chemicals

Growing demand for plastics fueled similar increases in the demand for ethylene and propylene, major feedstocks used in the manufacture of plastics. Revenues for these two olefins were up significantly for the year.

In the area of specialty chemicals, revenues were up in 1987, and the company began expanding production capacities for selected products.

As crude prices increased during the year, drilling activity picked up, and demand strengthened for the company's line of drilling mud additives and other oil field chemicals. Revenues were up for Drilling Specialties Company, which manufactures and markets these products.

Revenues also were up for Catalyst Resources Inc., a subsidiary that manufactures polymerization catalysts for the plastics industry.

Plastics Demand Surges

Sales volumes reached record levels in 1987 for the company's plastic resins and products businesses.

The company's polypropylene facilities near Houston were expanded by about 70 percent during the year to meet growing demand for this product. Phillips Marlex® polypropylene is used in synthetic fibers and other plastic products. In addition, the company manufactures Marlex® a family of polyethylenes produced by the world's most widely used high-density process.

A debottlenecking of polyethylene and a major capacity expansion of K-Resin® were under way at the end of the year. K-Resin® is a clear plastic used in disposable containers and packaging.

Sales volumes were up for Phillips Driscopipe Inc. This subsidiary has five plants that manufacture polyethylene pipe primarily for gas distribution, municipal and industrial uses.

Sales volumes were strong for the company's line of advanced composites, a new business formed in 1986. Advanced composites, often referred to as synthetic metals, are based on Phillips Ryton® engineering plastics and are widely used in the aerospace, defense and industrial markets.

Phillips Fibers Corporation had record sales volumes for the fifth year in a row. Demand continued to be strong for polypropylene fibers and for nonwoven fabrics used in the textile and civil engineering markets.

Strategy: Expand Facilities to Meet Growing Demand

Polyolefin markets are expected to grow about 6 percent a year over the next five years, and Phillips plans to expand capacity in line with this projected growth. During the coming year, the company will make expenditures to expand its ethylene and polyethylene businesses, as well as its K-Resin® and fibers businesses.

Strategy: Build on Strong Technology Base

Phillips chemicals business is well-established and has a strong technology base. In looking to the future, the company intends to expand in areas where it sees future growth and where it has strong operations, as well as research expertise.

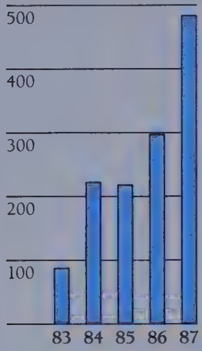
In addition, the company intends to continue to commercialize new products

derived from Phillips technology. For example, two new resins, recently developed by the company's Research and Development staff, are now in the development stage and could be ready for commercialization within the next few years. These resins complement and extend existing K-Resin® and Ryton® product lines. One resin, polymethylpentene, is a transparent thermoplastic and is expected to be used in packaging medical and laboratory ware. The other, polyarylene sulfide, has outstanding heat resistance and excellent potential for use in aerospace and defense applications.

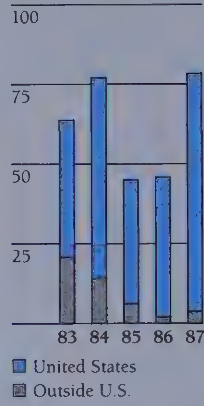
A construction worker labors high above the Houston Chemical Complex, where an expansion was completed in 1987 to increase polypropylene production by some 70 percent. Other expansions also are under way to meet growing demand for plastics.

Chemicals Statistics

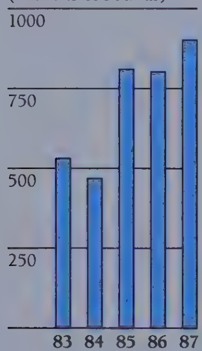
Operating Profit
(Millions of Dollars)



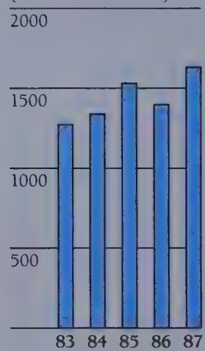
Capital Expenditures
(Millions of Dollars)



Ethylene Sales
(Millions of Pounds)

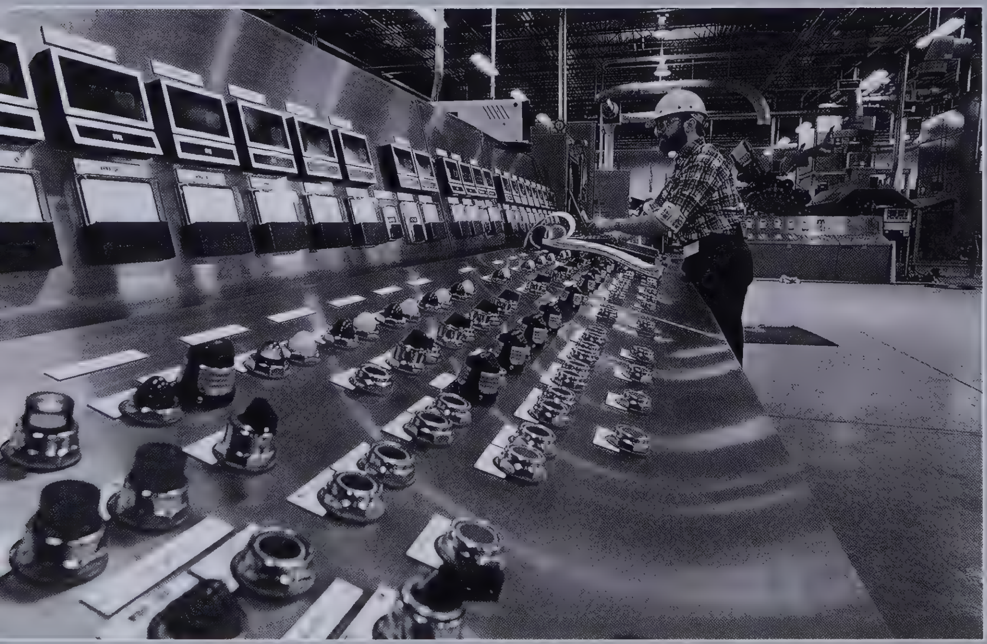


Polyethylene Sales
(Millions of Pounds)



	Millions of Dollars				
	1987	1986	1985	1984	1983
Operating Revenues					
Basic petrochemicals and specialty chemicals	$ **836**	748	1,097	1,092	998
Plastic resins	**783**	622	625	638	572
Synthetic fibers	**158**	146	139	127	120
Plastic pipe	**101**	87	91	93	87
Rubber chemicals*	**—**	61	187	214	234
Consumer products*	**—**	—	—	—	46
Fertilizers*	**—**	6	80	92	95
Other sales and services	**50**	28	47	95	103
	$1,928	1,698	2,266	2,351	2,255

**Operations sold.*



An employee monitors production at a Phillips fibers plant in Seneca, S.C. This business had record sales volumes for the fifth year in a row.

People

In response to low petroleum prices, the company announced late in the year that it planned an income-improvement program, part of which involves a work force reduction and consolidation of various operations and staffs. As the company continues to streamline its operations, employees are taking on broader responsibilities, are more involved in the decision-making process and are rededicating their efforts to maintaining a high standard of quality in their work.

Phillips Continues Work Force Consolidations, Reductions

The company's upstream operations—Exploration and Production and Gas and Gas Liquids—were consolidated early in 1988 to achieve greater operating efficiencies. Other organizational changes, as well as work force reductions, are planned in 1988 as the company continues to adapt to an environment of low energy prices.

At the end of 1987, Phillips work force numbered 22,500, up 700 from the previous year. The increase was primarily in the company's downstream operations of Petroleum Products and Chemicals, both of which have been expanding operations to meet growing consumer demand.

Employees Find New Ways to Generate Savings

Participation in the company's Suggestion Plan continued to be brisk, with an average of 81 suggestions submitted for each 100 eligible employees. First-year tangible savings from employee suggestions were $16.5 million, compared with $15 million the previous year. Employees received a total of $1.2 million for their suggestions, compared with $1.3 million in 1986. Two suggestions received the maximum $50,000 suggestion award.

Participative Action Teams (PAT) also contributed to efficiency and profitability. These teams, which act as quality control circles, meet regularly to solve work-related problems and encourage innovation. Since the PAT program began in 1981, costs have been reduced by some $19 million.

In 1987 the company initiated a new Special Stock Award Program to recognize outstanding performance by an employee or group of employees. During the year, 168 employees received a total of 35,335 shares of Phillips common stock under this new program.

Improving Safety Continues to be Major Priority

Phillips continues to have one of the best safety records among the major oil companies. Recordable injuries were 2 percent lower for the year, with lost workday cases down 54 percent. Property loss was down 50 percent.

Highlighting the company's strong commitment to safety was the successful jack up of the Ekofisk platforms in the Norwegian North Sea. The operation consumed 4.9 million manhours and involved lifting six platforms weighing more than 40,000 tons. The project was completed without a single lost workday incident.

Members of "Interests Unlimited," a Participative Action Team, collaborate over a new publication designed to enhance the relationship between Phillips and the many royalty owners with whom the company does business.

Technology

The company is committed to enhancing the profitability of its main businesses through the application of high technology and strong research and development. During the year, this commitment was evident in a number of projects, ranging from reducing finding costs for oil and natural gas, to starting a new business in the area of waste incineration, to bringing a new plastic one step closer to commercialization.

Incinatrol Company Formed

A new company, Incinatrol Inc., was formed late in the year. Incinatrol is a joint-venture corporation established by subsidiaries of Phillips and United Engineers & Constructors Inc., a Raytheon company. Headquartered in Denver, Incinatrol will design and build hazardous waste incineration facilities based on technology developed by Phillips research and development staff. Phillips has operated a hazardous waste incinerator at its research facilities in Bartlesville, Okla., since 1984, when it became the first company to receive a U.S. government operating permit under current law. Since then, more than 4 million pounds of hazardous waste have been destroyed by the Phillips incinerator in an environmentally acceptable process.

Research Aids Exploration and Production Effort

A number of steps were taken during the year to enhance the operations of Exploration and Production.

At the Greater Ekofisk Development in the Norwegian North Sea, reservoir studies assisted with both the platform elevation project, completed in early September, and the waterflood, which began in December. The company is using laboratory and computer studies to examine the mechanisms of oil, water and gas flow to optimize future enhanced recovery methods.

Finding costs for oil and natural gas have been reduced through land 3-D seismic data acquisition and processing methods that more accurately image and locate hydrocarbon-bearing formations. Finding costs also are being lowered by developing and enhancing reservoir engineering and geoscience workstations. These workstations help manage technical data more effectively and improve individual productivity.

Research Aimed at Improving Petroleum Processes

To improve the profitability of the company's refining operations, working models of major units were developed during the year that aid in determining the most economic raw materials to process and which help improve yields from refinery operations. In related research, efforts are proceeding to improve the characterization of crude oils and the company's ability to predict their processability and yields.

Research Brings Plastic Closer to Commercialization

A plastic, developed in 1986 by Phillips researchers, came one step closer to commercialization during the year after pilot plant studies yielded information for the design of a small commercial plant. Market development will begin in 1988. The plastic, polymethylpentene, is clear and intended for medical and laboratory products packaging.

In other areas of the plastics business, technology was developed during the year for producing new glass-reinforced engineering thermoplastics based on polyolefin and polyester resins. The new products complement the company's line of Ryton® polyphenylene sulfide engineering plastics, which are heat- and corrosion-resistant.

The company also produced a new advanced composite in 1987 which has market potential for demanding aerospace applications.

Improvements have been made to a process that produces silicon carbide and silicon nitride powders from inexpensive feedstocks. These high-purity ceramic powders are used for electronic and heat engine applications.

Chemical Processes Improved Through Research

An improved process was developed and implemented during the year that enables the company to recover a valuable petrochemical used in the plastics industry. The improved process results in greater yields, higher purity and lower energy consumption.

Construction is taking place in Dumas, Texas, on the first commercial plant to use a process and catalyst developed by Phillips to reduce sulfur oxide emissions. The plant is scheduled to start up in 1988.

Research efforts also are under way to support growing markets for the company's specialty chemicals. During the year, commercial applications were developed for a degreaser additive, a herbicide component, silver polish, sealants and a rocket fuel plasticizer. Now being developed are such potential products as lubricant additives, specialty electronic solvents, polymer membranes, flavors and fragrances. During the year, the company's expertise in pheromone research aided in the development of a new class of environmentally compatible chemicals used in insect control.

Biotechnology Research Finds Medical Applications

During the year, Phillips and the Baylor College of Medicine formed a company to market diagnostics used to measure the level of tobacco product exposure, antibodies and related products used in medical research.

The company also strengthened the commercialization potential of its yeast recombinant technology with agreements to produce human serum albumin and salmon growth hormone.

Phillips Continues to Lead Industry in Active Patents

Phillips received 207 U.S. and 377 foreign patents in 1987. At the end of the year, the company held 4,941 active U.S. patents, the most of any oil company.

Researcher Lori Hasselbring extracts residue from air-sensitive catalysts. A major thrust of Phillips research and development is providing support to growing markets for the company's specialty chemicals.

Corporate Citizenship

Contributing to the vitality and health of the communities where Phillips operates has long been a major priority of the company. However, it is recognized that being a good corporate citizen extends beyond the confines of a single community or a narrow geographic region. Indeed, responsible citizenship demands that a company work to effect a higher quality of life for the nation as a whole. Phillips believes that responsible citizenship comes in part from working with elected officials to forge a national energy policy that will encourage companies to invest in exploration in stable areas of the world so that the United States will be less dependent on insecure, foreign supplies of crude oil. The company is committed to this challenge and is dedicated to doing its part to build a more secure energy future.

Charitable Dollars Total $6.7 Million

In 1987 Phillips contributed $6.7 million to organizations involved in youth, civic, cultural, educational, health and welfare activities. Of this, approximately $4 million went to education. Some 470 colleges and universities benefited from this support.

Amateur Swimmers, Divers Receive Company Support

During the year, Phillips agreed to continue as national sponsor of United States Swimming and United States Diving. The organizations, which sponsor swimming and diving clinics and competitions for youngsters, help prepare U.S. athletes to compete in the Olympics. The company has been national sponsor of United States Swimming since 1973 and United States Diving since 1979.

$164 Million Spent to Protect Environment

In 1987 capital expenditures of $55 million were approved to protect and improve the environment, while another $109 million was spent to operate and maintain existing environmental control systems. During the year, new storm-water handling systems were installed at several major terminals and a new process for recovering sulfur removed from natural gas was developed. The company now has plans to use its hazardous waste technology to install an incinerator at the Sweeny, Texas, refinery to handle wastes from Phillips facilities on the Gulf Coast.

Phillips Helps Shape National Public Policies

During the year, Phillips continued its efforts to enhance the public's understanding of the petroleum and petrochemical industries and to influence government policy in a direction compatible with maintaining a secure energy future. Issues of national importance, which are now being debated and which the company supports, are access to federal lands for energy development, especially the U.S. outercontinental shelf and the Arctic National Wildlife Refuge; repeal of the windfall-profit tax on crude oil production; reform of federal regulations on natural gas production and transportation; and enactment of cost-effective environmental laws and regulations.

A young violinist perfects her skills at the Oklahoma Summer Arts Institute, an intensive workshop that brings the state's finest talent in contact with the country's leading instructors and performers. The OSAI is just one of many youth-related programs that Phillips sponsors.

Financial Review 1987

Contents

Oil and Gas Operations

In accordance with Financial Accounting Standards Board (FASB) Statement No. 69, "Disclosures about Oil and Gas Producing Activities," and regulations of the Securities and Exchange Commission (SEC), the company is making certain disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data are necessarily imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the present financial condition of the company or its expected future results.

Management's Discussion and Analysis
February 16, 1988

HIGHLIGHTS
Consolidated net income for 1987 was $35 million, compared with $228 and $418 million for 1986 and 1985, respectively. Revenues for 1987 were $10.9 billion, compared with $10.0 billion for 1986 and $15.8 billion for 1985.

Petroleum prices continued to be an important factor affecting the company's performance during 1987. Although crude oil prices rebounded in 1987, they remained far below the 1985 level. The company's average price for natural gas declined during 1987 while prices for natural gas liquids improved but proportionately not as much as crude oil. Natural gas and natural gas liquids accounted for 60 percent of the company's hydrocarbon production. In addition, hydrocarbon production during 1987 declined from 1986 levels.

The company's chemicals operations had one of its best years—reflecting strong demand for its products. Pretax earnings were up 61 and 120 percent, compared with 1986 and 1985, respectively.

In addition to the operating results noted above, these are some of the year's highlights:

- Revisions of previous reserve estimates, discoveries of new reserves and extensions of existing reserves allowed the company to replace, on a barrel-of-oil-equivalent basis, all of the hydrocarbon reserves it produced.
- Offshore Norway, the company successfully completed the elevation of six offshore platforms in the Ekofisk complex to compensate for the subsidence of the ocean floor. In addition, the largest enhanced oil recovery project in Phillips history began late in 1987, when the company began injecting water into the Ekofisk field. The waterflood is expected to increase recovery from the field by approximately 140 to 170 million gross barrels of oil equivalent.
- Phillips reduced its total debt to $5.6 billion in 1987. Total debt has declined $3.0 billion since the company's Exchange Offer in March 1985.
- The company announced in December that it would consolidate its Exploration and Production and Gas and Gas Liquids operations and reduce its worldwide work force. These changes are expected to cut costs by $150 to $200 million annually.

Summary of Income

Years Ended December 31	Millions of Dollars		
	1987	1986*	1985*
Petroleum			
Exploration and Production			
United States	$ (44)	(146)	606
Outside United States	425	401	1,273
	381	255	1,879
Gas and Gas Liquids	39	(8)	291
Refining, Marketing and Transportation	201	458	342
	621	705	2,512
Chemicals	482	299	219
Corporate and Other	(837)	(330)	(1,100)
Income before Income Taxes	266	674	1,631
Income Taxes	231	446	1,213
Net Income	$ 35	228	418

**Reclassified—see Note 1 of the Notes to Financial Statements.*

RESULTS OF OPERATIONS
Consolidated net income for 1987 benefited from higher crude oil sales prices, continued strong performance from chemicals operations and lower depreciation, depletion, amortization and retirements. These factors were partly offset by decreased margins on refining and marketing products and foreign currency losses in 1987 versus gains in 1986. Included in 1986 earnings were gains of $148 million from restructuring the company's retirement plan and $146 million from the asset disposition program, partly offset by special charges totaling $174 million, which consisted of a charge resulting from a special separation and reorganization program, write-off of suspended wells and a reduction in reserve quantities due to economic conditions.

The following demonstrates the change in 1987 average sales prices, compared with 1986:

	1987	1986	Change
Crude Oil (per barrel)			
United States	$16.35	13.83	18%
Outside United States	17.69	14.35	23
Natural Gas (per thousand cubic feet)			
United States	1.48	1.70	(13)
Outside United States	2.77	3.87	(28)
U.S. Natural Gas Liquids (per barrel—unfractionated)	8.11	7.89	3
U.S. Natural Gas Liquids Product (per barrel—fractionated)	11.14	10.94	2
Automotive Gasoline (per gallon)	.57	.49	16
Distillates (per gallon)	.54	.48	13
Liquefied Petroleum Gas (per gallon)	.28	.30	(7)

For 1987, the company's worldwide production of crude oil, natural gas and natural gas liquids was down 8, 3 and 10 percent, respectively. Contributing to the declines in production were the sale of selected producing properties in 1986, the normal decline that occurs in fields as they mature and certain government mandated curtailments.

Petroleum Exploration and Production

Pretax earnings for 1987 were $381 million, compared with $255 million in 1986 and $1.9 billion in 1985.

Domestic operations showed a pretax loss of $44 million, compared with a pretax loss of $146 million in 1986 and pretax earnings of $606 million in 1985. The improvement in 1987 was due primarily to higher crude oil sales prices, lower lifting costs and lower depreciation, depletion, amortization and retirements, partly offset by lower crude oil sales volumes and lower natural gas sales prices and volumes.

Pretax earnings outside the United States were $425 million in 1987, compared with $401 million in 1986 and $1.3 billion in 1985. The increase was due primarily to higher crude oil sales prices, higher natural gas sales volumes, lower exploration expenses (primarily dry holes) and lower depreciation, depletion, amortization and retirements. These factors were partly offset by lower crude oil sales volumes, lower natural gas sales prices and the costs associated with the successful elevation of the platforms in the Norwegian North Sea.

Worldwide depreciation, depletion, amortization and retirements was high in 1986 primarily due to the collapse in crude oil prices which triggered a reduction in reserve quantities previously estimated to be economically recoverable.

Gas and Gas Liquids

Pretax earnings were $39 million, compared with a pretax loss of $8 million in 1986 and pretax earnings of $291 million in 1985. The improvement in 1987 was due primarily to lower natural gas purchase costs and higher sales prices for natural gas liquids and liquefied natural gas, partly offset by lower residue gas sales prices and lower sales volumes for natural gas liquids.

Petroleum Refining, Marketing and Transportation

Pretax earnings were $201 million, compared with $458 million in 1986 and $342 million in 1985. The decline was due mainly to higher feedstock costs, partly offset by higher sales prices.

Chemicals

Chemicals had one of its best years in 1987 with pretax earnings increasing to $482 million, compared with $299 million in 1986 and $219 million in 1985. This increase was due principally to higher sales prices and volumes, reflecting strong demand for the company's chemical products during 1987.

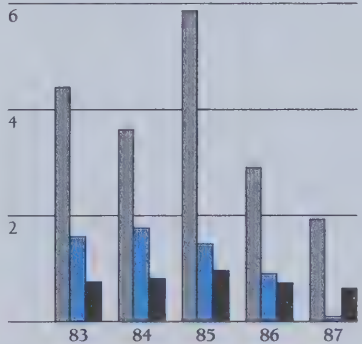
Corporate and Other

Corporate and Other, consisting primarily of interest expense, interest income and unusual items, reflected a pretax loss of $837 million in 1987, compared with pretax losses of $330 million and $1.1 billion in 1986 and 1985, respectively. The difference was due primarily to benefits in 1986 related to gains from restructuring the company's retirement plan and the asset disposition program, partly offset by greater expense in 1986 for the company's special separation and reorganization programs. The operating results of Corporate and Other for 1986 and 1985 have been restated to include the company's minerals operations which were formerly reported as discontinued (see Note 1 of the Notes to Financial Statements).

Provision for Income Taxes

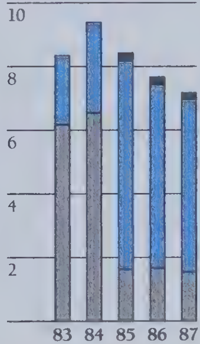
The provision for income taxes was $231 million in 1987, compared with $446 million and $1.2 billion in 1986 and 1985, respectively. Lower financial income was the primary reason for the lower income tax

Total Taxes, Net Income and Cash Dividends
(Dollars Per Average Common Share)



Total Taxes
Net Income
Cash Dividends

Capitalization
(Billions of Dollars)



Preferred Stock
Long-Term Debt
Common Equity

provision in 1987. The effective income tax rate was 87 percent in 1987, compared with 66 percent in 1986 and 74 percent in 1985. The predominance of highly taxed foreign income, coupled with domestic losses which are benefited at lower tax rates, was the primary reason for the higher effective tax rate in 1987.

In late December 1987, FASB issued Statement No. 96, "Accounting for Income Taxes," which is effective for fiscal years beginning after December 15, 1988. This Statement significantly changes the standards under which deferred income taxes are computed and a determination has not been made at this time as to its impact on the company. The company has not determined if it will adopt the Statement in 1988.

CAPITAL RESOURCES AND LIQUIDITY

The company's current ratio, the ratio of current assets to current liabilities, was 1.2 at year-end 1987, compared with 1.3 for 1986. Funds generated from operations in 1987 covered the company's capital expenditures, dividends and scheduled debt payments. However, the company elected to retire $230 million of debt and preferred stock early, and as a result, cash and short-term investments were reduced $135 million. The company continues to maintain cash balances in excess of day-to-day operating needs because oil and gas prices remain unpredictable. These cash balances, together with cash flow from operations, are expected to meet the company's anticipated liquidity requirements.

The company's short-term liquidity position is $353 million stronger than indicated because inventories are valued using the last-in, first-out (LIFO) method, which values inventories at historical costs which are lower than current prices.

During 1987, the company continued its emphasis on repaying debt obligations by reducing long-term debt $339 million, to $5.4 billion. The reduction in long-term debt was composed of $161 million of early debt retirements and $178 million now classified as current.

In addition to the reduction in debt, the company, under a repurchase program which expired December 31, 1987, repurchased and retired 2,859,665 and 619,739 shares of the Series A preferred stock at a cost of $69 and $15 million, respectively, during 1987 and 1986. The shares retired under this program represent 29 percent of the total originally issued.

As part of its continuing effort to improve earnings, the company announced in December that it would consolidate its Exploration and Production and Gas and Gas Liquids operations and reduce its worldwide work force. The changes are expected to reduce expenses by $150 to $200 million annually.

The company indefinitely postponed its proposed issue of $400 million in convertible subordinated debentures due 2012 due to unsatisfactory market conditions. The proceeds of the issue were expected to be used to reduce other debt and obligations.

Phillips worldwide operations are capital intensive, requiring significant expenditures over long construction periods. Capital expenditures for properties, plants and equipment totaled $750 million in 1987, compared with $660 million in 1986 and $1.1 billion in 1985. Over the past three years, significant expenditures have been made for developing the Point Arguello field in the Santa Maria Basin offshore California and the waterflood project in the Norwegian North Sea; for developing existing domestic properties and connecting new gas to existing facilities; for modernizing and improving the feedstock flexibility of Phillips major refineries; and for modernizing Phillips retail gasoline outlets. During this period, about 75 percent of the company's capital expenditures were made in the United States. Over the three-year period, capital expenditures for Petroleum Exploration and Production operations accounted for 57 percent of the total; Gas and Gas Liquids operations—11 percent; Petroleum Refining, Marketing and Transportation operations—12 percent; Chemicals operations—7 percent; and Corporate and Other—13 percent.

In addition to expenditures for properties, plants and equipment, other investments of $35 million were made during 1987 in companies where Phillips ownership is 50 percent or less. These investments primarily relate to transportation and processing facilities which support the company's Point Arguello development.

Properties, plants and equipment decreased $414 million during the year reflecting, in part, that current capital expenditures are less than current depreciation, depletion and amortization.

The company's proved reserves of crude oil and natural gas increased 4 and 3 percent, respectively, while proved reserves of natural gas liquids decreased 11 percent. While revisions of previous estimates were primarily responsible for the increase in reserves, discoveries of new reserves and extensions of existing reserves also contributed.

Over the past three years, Phillips has charged against income a total of $1.3 billion relating principally to its worldwide exploration for petroleum reserves. A comparison of the components of exploration expense is shown below.

	Millions of Dollars		
	1987	1986*	1985*
Geological and geophysical	**$130**	135	213
Leasehold impairment	**196**	193	148
Dry hole	**31**	120	84
Lease rentals	**9**	11	17
	$366	459	462

**Restated—see Note 1 of the Notes to Financial Statements.*

The company's major net income exposures to foreign currency movements are due to its foreign deferred tax liabilities. Changes in the value of the dollar against certain foreign currencies can result in sizable fluctuations in net income because FASB Statement No. 52, "Foreign Currency Translation," requires foreign deferred taxes to be valued at current exchange rates. The company does not hedge these exposures because gains and losses on foreign deferred taxes do not impact cash flow. The company hedges, where feasible and appropriate, foreign exchange exposures which impact cash flow.

CHANGING PRICES AND THE EFFECT OF INFLATION

Market conditions continue to be the primary factor in determining the prices and costs of company products. Inflation has not had a significant effect on other aspects of the company's operations.

OUTLOOK

Looking forward to 1988, the major uncertainty remains the price of oil and gas. An environment of fluctuating oil and gas prices requires constant reassessment of spending plans on long-term projects. Phillips expects that capital expenditures for 1988 will be approximately $825 million. About half of this total will be devoted to the company's upstream operations—primarily to continue work on projects now under way to maintain production, as well as an active but somewhat smaller exploration program. Major investments will include development of the Audrey gas field in the U.K. sector of the North Sea, continued development of the Point Arguello field offshore California and the waterflood project at the Ekofisk field. Expenditures for downstream operations will increase by approximately $100 million to almost $300 million. Downstream capital expenditures will include increasing production capacities for Marlex® and K-Resin® to meet growing customer demand; constructing an HF alkylation unit at the Sweeny, Texas, refinery which will increase high-octane unleaded motor fuel production and support the company's expanding motor fuel sales program; and modernizing Phillips retail gasoline outlets.

Phillips Coal Company reached an agreement with Texas-New Mexico Power Company in November 1987 to supply lignite to an electric generating plant being built in east-central Texas. The agreement provides for Phillips to supply up to 3.3 million tons of lignite per year for 38 years. Construction of the mine is expected to begin in 1988 with first deliveries expected in late 1989.

Because of development projects currently under way or planned, the company expects to be able to hold crude production near the 1987 level for the next two to three years. This assumes no additional government-mandated curtailments in production. The company, because of discoveries and current development projects, also expects to maintain natural gas production near the 1987 level for the next two to three years, barring changes in market conditions or government regulations, or additional government curtailments.

The company's financing alternatives continue to be affected by the current level of long-term debt and attendant interest expense, continuing uncertainty in oil and gas prices, and the noninvestment-grade ratings of the company's bonds. Over the next several years, Phillips anticipates reducing its total debt to between $4.5 and $5.0 billion. To meet its liquidity requirements and reduce existing debt balances, the company will look primarily to funds from operations and existing cash balances.

Common Stock Prices and Cash Dividends Per Share

	1987			1986		
	Stock Price		Dividends	Stock Price		Dividends
Quarter	High	Low		High	Low	
First	$16¼	11¾	.15	12¾	9¼	.25
Second	17⅛	13⅜	.15	11⅛	9¼	.15
Third	18¾	15⅝	.15	11¼	8¼	.15
Fourth	17¼	10	.15	12⅛	9⅝	.15
Closing Stock Price at December 31, 1987						$14
Number of Stockholders of Record at January 31, 1988						100,382

Phillips common stock is traded on the New York, Pacific and Toronto stock exchanges.

Selected Financial Data

	Millions of Dollars Except Per Share Amounts				
	1987	1986*	1985*	1984*	1983*
Sales and other operating revenues	$10,721	9,788	15,676	15,537	15,249
Net income	35	228	418	810	721
Net income per common share**	.06	.89	1.44	1.75	1.57
Total assets	12,111	12,403	14,052	16,965	13,094
Long-term debt	5,419	5,758	6,548	2,840	2,242
Redeemable preferred stock	205	270	281	—	—
Cash dividends declared Per common share**	.60	.70	.95	.78	.73
Per preferred share	1.73	2.02	1.04	—	—

**Restated—see Note 1 of the Notes to Financial Statements.*
***Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

See Management's Discussion and Analysis for discussion of factors that would enhance an understanding of these financial data.

Report of Certified Public Accountants

The Board of Directors and Stockholders
Phillips Petroleum Company

We have examined the accompanying consolidated balance sheet of Phillips Petroleum Company at December 31, 1987 and 1986, and the related consolidated statements of operations, changes in common stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Phillips Petroleum Company at December 31, 1987 and 1986, and the consolidated results of operations and changes in financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Tulsa, Oklahoma
February 16, 1988

Consolidated Statement of Operations

PHILLIPS PETROLEUM COMPANY

Years Ended December 31	Millions of Dollars		
	1987	1986*	1985*
Revenues			
Sales and other operating revenues	$10,721	9,788	15,676
Equity in earnings of affiliated companies	86	64	37
Other revenues	110	166	127
Total Revenues	10,917	10,018	15,840
Costs and Expenses			
Purchased crude oil and products	6,221	5,313	9,041
Production and operating expenses	1,783	1,628	1,855
Exploration expenses	366	459	462
Selling, general and administrative expenses	370	308	419
Depreciation, depletion, amortization and retirements	922	1,096	1,051
Taxes other than income taxes	217	210	412
Interest and expense on indebtedness	729	685	846
Unusual items	43	(355)	123
Total Costs and Expenses	10,651	9,344	14,209
Income before income taxes	266	674	1,631
Provision for income taxes	231	446	1,213
Net Income	$ 35	228	418
Net Income Applicable to Common Stock	$ 13	202	401
Net Income Per Share of Common Stock	$ .06	.89	1.44
Average Common Shares Outstanding (in thousands)	228,326	227,546	278,916

**Reclassified—see Note 1.*
See accounting policies and notes to financial statements.

Consolidated Balance Sheet

PHILLIPS PETROLEUM COMPANY

At December 31	Millions of Dollars	
	1987	1986*
Assets		
Current Assets		
Cash and short-term investments	$ 1,006	1,141
Accounts and notes receivable (less allowances: 1987—$14; 1986—$10)	1,269	1,047
Inventories	543	507
Prepaid expenses and other current assets	67	107
Total Current Assets	2,885	2,802
Investments and long-term receivables	377	316
Properties, plants and equipment (net)	8,772	9,186
Deferred charges	77	99
Total	$12,111	12,403
Liabilities		
Current Liabilities		
Accounts payable	$ 1,016	924
Long-term debt due within one year	178	182
Accrued income and other taxes	929	901
Other accruals	279	227
Total Current Liabilities	2,402	2,234
Long-term debt	5,419	5,758
Accrued dismantlement, removal and restoration costs	303	269
Accrued contingent liabilities	163	201
Deferred income taxes	1,705	1,685
Other liabilities and deferred credits	263	238
Minority interest in consolidated subsidiaries	34	24
Total Liabilities	10,289	10,409
Redeemable Preferred Stock		
Series A Adjustable Rate ($1.00 par value)		
Shares issued and outstanding (1987—8,481,795; 1986—11,341,460) (mandatory redemption value: 1987—$212; 1986—$284)	205	270
Common Stockholders' Equity		
Common stock—500,000,000 shares authorized at $1.25 par value		
Issued (248,684,301 shares)		
Par value	311	311
Capital in excess of par	224	224
Treasury stock (at cost: 1987—20,333,852 shares; 1986—20,351,602 shares)	(1,238)	(1,241)
Foreign currency translation adjustments	(31)	(49)
Earnings employed in the business	2,351	2,479
Total Common Stockholders' Equity	1,617	1,724
Total	$12,111	12,403

**Reclassified—see Note 1.*
See accounting policies and notes to financial statements.

Consolidated Statement of Changes in Financial Position

PHILLIPS PETROLEUM COMPANY

Years Ended December 31	Millions of Dollars		
	1987	1986*	1985*
Funds from Operations			
Net income	$ 35	228	418
Items not affecting working capital:			
Depreciation, depletion, amortization and retirements	922	1,096	1,051
Dry hole costs and leasehold impairment	227	313	232
Deferred taxes	38	(214)	240
Other	(3)	(136)	189
Funds from operations before changes in working capital	1,219	1,287	2,130
Working capital changes, excluding changes in cash, short-term investments and debt:			
Accounts and notes receivable	(222)	601	32
Inventories	(36)	137	230
Prepaid expenses and other current assets	40	75	(19)
Accounts payable	92	(414)	(350)
Taxes and other accruals	80	(417)	(153)
	1,173	1,269	1,870
Investment Activities			
Capital expenditures, including dry hole costs	(750)	(660)	(1,088)
Property sales and retirements	45	554	1,034
Pension plan reversion	—	203	—
Investment purchases	(35)	(23)	—
Investment sales	1	180	7
Other (net)	(9)	(59)	136
Funds provided from (used for) investment activities	(748)	195	89
Financing Activities			
Decrease in notes payable	—	(24)	(1,860)
Increase (decrease) in long-term debt due within one year	(4)	(25)	125
Additional long-term debt	—	11	5,576
Reduction of long-term debt	(332)	(776)	(1,864)
Purchase of company stock	(69)	(15)	(4,972)
Issuance of company stock	1	13	372
Dividends to company stockholders	(156)	(183)	(554)
Funds used for financing activities	(560)	(999)	(3,177)
Increase (Decrease) in Cash and Short-Term Investments	$ (135)	465	(1,218)

**Reclassified—see Note 1.*
See accounting policies and notes to financial statements.

Consolidated Statement of Changes in Common Stockholders' Equity

PHILLIPS PETROLEUM COMPANY

	Shares of Common Stock			Millions of Dollars				
				Common Stock				
	Issued	Held in Treasury	Outstanding	Par Value	Capital in Excess of Par	Treasury Stock	Foreign Currency Translation Adjustments	Earnings Employed in the Business
December 31, 1984	154,951,981	325,275	154,626,706	$194	499	(16)	(110)	6,057
Net income								418
Cash dividends declared and paid Common								(261)
Preferred								(12)
Common stock dividend	93,732,320	(53,000,000)	146,732,320	117	(353)	3,232		(2,996)
Preferred stock dividend								(281)
Sold to employee benefit plans		(7,240,100)	7,240,100		67	442		(416)
Exchange offer		72,580,000	(72,580,000)			(4,500)		
Stock purchases		8,898,800	(8,898,800)			(472)		
Issued under incentive compensation plans		(20,344)	20,344			1		
Current period translation adjustment							51	
Translation adjustment recognized upon disposal of foreign investments							(15)	
Accretion of discount on preferred stock								(2)
December 31, 1985	248,684,301	21,543,631	227,140,670	311	213	(1,313)	(74)	2,507
Net income								228
Cash dividends declared and paid Common								(159)
Preferred								(24)
Issued under incentive compensation plans		(1,192,029)	1,192,029		11	72		(70)
Current period translation adjustment							15	
Translation adjustment recognized upon disposal of foreign investments							10	
Accretion of discount on preferred stock								(3)
December 31, 1986	248,684,301	20,351,602	228,332,699	311	224	(1,241)	(49)	2,479
Net income								35
Cash dividends declared and paid Common								(137)
Preferred								(19)
Issued under incentive compensation plans		(17,750)	17,750			3		(4)
Current period translation adjustment							18	
Accretion of discount on preferred stock								(3)
December 31, 1987	**248,684,301**	**20,333,852**	**228,350,449**	**$311**	**224**	**(1,238)**	**(31)**	**2,351**

See accounting policies and notes to financial statements.

Accounting Policies

Consolidation Principles and Investments—The consolidated financial statements include the accounts of companies owned more than 50 percent except for Phillips Petroleum Credit Corporation and Walton Insurance Limited. Investments in these two companies, in companies owned 20 to 50 percent, inclusively, and in corporate joint ventures are accounted for using the equity method of accounting (affiliated companies). Investments in other companies are carried at cost.

Inventories—Crude oil, petroleum products, chemicals and merchandise are valued at cost, which is lower than market in the aggregate, mainly on the last-in, first-out (LIFO) basis. Materials and supplies are valued at or below average cost.

Oil and Gas Exploration and Development—Oil and gas exploration and development costs are accounted for using the successful efforts method of accounting.

Property Acquisition Costs—Oil and gas leasehold acquisition costs are capitalized. Leasehold impairment is recognized based upon unsuccessful exploratory experience. Upon discovery of commercial reserves, leasehold costs are transferred to producing properties.

Exploratory Costs—Geological and geophysical expenses and the costs of carrying and retaining undeveloped properties are charged against income as incurred. Exploratory drilling costs are capitalized when incurred. If exploratory wells are determined to be commercially unsuccessful or dry holes, applicable costs are expensed.

Development Costs—Costs incurred to drill and equip development wells, including unsuccessful development wells, are capitalized.

Depletion and Amortization—Leasehold costs of producing properties are depleted using the unit-of-production method based on estimated proved oil and gas reserves. Amortization of intangible development costs is based on the unit-of-production method using the estimated proved developed oil and gas reserves.

Depreciation and Amortization—Depreciation and amortization of properties, plants and equipment, including assets under capital leases, are determined by the group straight-line method, individual unit straight-line method or the unit-of-production method, applying the method considered most appropriate for each type of property.

Property Dispositions—When complete units of depreciable property are retired or sold, the asset cost and related accumulated depreciation are eliminated with any gain or loss reflected in income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and salvage value is charged or credited to accumulated depreciation.

Maintenance and Repairs—Maintenance and repair costs are expensed as incurred. Significant improvements are capitalized.

Dismantlement, Removal and Restoration Costs—The estimated costs, net of salvage values, of dismantling and removing major facilities, including necessary site restoration, are accrued using either the unit-of-production or the straight-line method.

Foreign Currency Translation—The U.S. dollar is the functional currency for most of the company's operations. Adjustments resulting from the process of translating foreign functional currency financial statements into U.S. dollars are accumulated as a separate component of common stockholders' equity. Foreign currency transaction gains and losses are included in income.

Income Taxes—Deferred taxes are provided for all significant timing differences in the recognition of revenues and expenses for tax and financial purposes. Allowable tax credits are applied currently as reductions of the provision for income taxes. No provision for U.S. income taxes is made on undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds.

Income Per Share of Common Stock—Income per share of common stock is determined after deducting the dividend requirements of preferred stock and the accretion of the excess of redemption value of preferred stock over its carrying value. The calculation is based upon the daily weighted average number of common shares outstanding during the period.

Notes to Financial Statements

Note 1—Discontinued Operations and Unusual Items

During 1985, the company announced plans to discontinue its minerals segment which then consisted of coal, geothermal, shale oil, uranium and other minerals operations. Except for certain coal properties, substantially all minerals operations were sold or abandoned in 1985 and 1986. In late 1987, the company announced its decision to reactivate its coal operations. As a result of this decision, prior period financial statements have been reclassified to present the minerals segment as a continuing operation. The Notes to Financial Statements, where applicable, are restated to include minerals operations.

Unusual items consisted of the following for the years ended December 31:

	Millions of Dollars		
	1987	1986	1985
Special separation and reorganization programs	$(50)	(114)	(21)
Retirement plan restructuring	—	275	—
Asset disposition program	—	212	201
Minerals operations*	7	(18)	(303)
	$(43)	355	(123)

**Previously reported as loss on disposal of discontinued operations.*

Unusual items for 1987 included an accrual of $50 million for the estimated costs associated with a work force reduction and reorganization to be implemented in 1988. Unusual items decreased net income $26 and $35 million in 1987 and 1985, respectively, and increased net income $226 million in 1986.

Note 2—Inventories

Inventories at December 31 consisted of the following:

	Millions of Dollars	
	1987	1986
Crude oil, petroleum products and chemicals	$420	375
Merchandise	13	12
	433	387
Materials and supplies	110	120
	$543	507

Inventories valued on a LIFO basis totaled $371 and $325 million at December 31, 1987 and 1986, respectively, and would have been approximately $353 and $292 million higher, respectively, had they been valued using the first-in, first-out (FIFO) method. The FIFO values were determined using costs and allocations consistent with those used to determine LIFO inventories.

Note 3—Investments and Long-Term Receivables

Components of investments and long-term receivables at December 31 were as follows:

	Millions of Dollars	
	1987	1986
Investments in and advances to affiliated companies		
Walton Insurance Limited	$ 35	20
Companies owned 50 percent or less	168	150
Long-term receivables	58	121
Other investments	116	25
	$377	316

Earnings employed in the business at December 31, 1987, included $129 million relating to undistributed earnings of affiliated companies. Dividends received from affiliated companies were $58, $184 and $41 million in 1987, 1986 and 1985, respectively.

Walton Insurance Limited (Walton) participated in the international reinsurance business until January 27, 1983, when it ceased writing new third-party reinsurance. Walton also insured certain Phillips risks which it ceased underwriting in late 1987.

Note 4—Properties, Plants and Equipment

The company's investment in properties, plants and equipment (at cost) at December 31 is summarized as follows:

	Millions of Dollars	
	1987	1986
Exploration and Production	$ 8,886	8,798
Gas and Gas Liquids	2,055	2,022
Petroleum Products	2,992	2,881
Chemicals	1,406	1,332
Corporate and Other	1,136	1,064
	16,475	16,097
Accumulated depreciation, depletion and amortization	7,703	6,911
	$ 8,772	9,186

Note 5—Debt

Long-Term

Long-term debt due after one year at December 31 consisted of the following:

	Millions of Dollars	
	1987	1986
Floating Rate Senior Notes Due 1995*	**$1,573**	1,661
14¾% Subordinated Debentures Due 2000	**1,089**	1,089
13⅞% Senior Notes Due 1997	**1,299**	1,299
12⅞% Notes Due September 1, 1992	**187**	187
12¼% Debentures Due 2012	**294**	297
11¼% Debentures Due 2013	**227**	250
8⅞% Debentures Due 2000	**123**	149
7⅝% Debentures Due 2001	**76**	96
5⅝% Marine Terminal Revenue Bonds, Series 1977 Due 2007	**20**	20
Notes payable to banks, insurance companies and others due through 1993 At 9%–15½%	**11**	90
At 7%–8¹⁵⁄₁₆%	**340**	355
Production payment	**171**	253
Obligations under capital leases	**5**	6
Purchase obligations	**4**	6
	$5,419	5,758

**Interest rates at December 31, 1987 and 1986, were 9¾ and 7¹¹⁄₁₆ percent, respectively.*

Maturities of long-term debt in 1988 through 1992 are: $178 (included in current liabilities), $111, $87, $117 and $287 million, respectively.

Compensating Balances

The company maintains compensating balances for banking services under various arrangements with several banks. The compensating balances are not legally restricted as to withdrawal and are continually reviewed and adjusted based on levels of services and activity. The total of all compensating balances is not material in relation to total liquid assets.

Note 6—Interest Rate Swap Agreements

Included in deferred credits is $50 million the company received in 1987 when it entered into interest rate swap agreements with two banks. The company will make floating interest payments at the London Interbank Offering Rate over a period of five years based upon a notional amount of $140 million. The $50 million will be amortized over the term of the agreements. The company named each bank beneficiary of a $36 million standby letter of credit, with the stated amount of each letter of credit declining over the agreement term.

Note 7—Non-Mineral Operating Leases

The company leases service stations, computers and other facilities and equipment. At December 31, 1987, future minimum payments due under noncancelable operating leases were as follows:

	Millions of Dollars
1988	$ 36
1989	28
1990	19
1991	13
1992	10
Remaining years	82
Total payments	$188

Operating lease rental expense for the years ended December 31 was as follows:

	Millions of Dollars		
	1987	1986	1985
Total rentals	**$84**	94	111
Less sublease rentals	**6**	9	9
Net rentals	**$78**	85	102

Note 8—Redeemable Preferred Stock

Each Series A preferred share has a liquidation value of $25, with mandatory redemption on May 15, 1990. Each share is redeemable at the option of the company at $25.25 per share through May 14, 1988, and at $25 per share thereafter. The dividend rate is adjusted quarterly based on certain applicable U.S. Treasury rates. The dividend rate was 6.8 and 6.6 percent at December 31, 1987 and 1986, respectively. The preferred stockholders do not have voting rights unless dividends payable become six quarters in arrears, at which time the holders of the preferred, voting as a class, have the right to elect two directors. No dividends may be paid on common stock unless full cumulative dividends on the preferred stock have been declared and paid. The preferred stock was recorded at fair market value at issuance. The excess of the redemption value over the carrying value is accreted (added to book value) over the life of the issue.

Under a repurchase program that expired December 31, 1987, the company repurchased and retired 2,859,665 and 619,739 shares of the Series A preferred stock at a cost of $69 and $15 million, respectively, during 1987 and 1986.

Note 9—Preferred Share Purchase Rights

At December 31, 1987, there were 228,350,449 Preferred Share Purchase Rights (Rights) outstanding. The Rights are not exercisable or transferable, apart from the company's common stock, until after a person or group acquires, or has the right to acquire, beneficial ownership of 20 percent or more of the company's common stock or announces a tender or exchange offer for 30 percent or more of the company's common stock. Each Right entitles the holder to purchase one one-hundredth of a share of a new series of preferred stock for $35 and contains anti-dilution provisions that entitle the holder, in the event of specific transactions, to purchase common stock of the surviving corporation at one-half of market price as determined under the terms of the Rights Agreement. The Rights will expire on July 10, 1993, unless previously redeemed at the option of the company for 8⅓ cents per Right or exercised.

Note 10—Other Contingent Liabilities

In addition to accrued contingent liabilities shown on the balance sheet, the company has other contingent liabilities for which no provision has been made. These include a number of legal proceedings pending in various courts or agencies in which the company or a subsidiary appears as plaintiff or defendant.

At December 31, 1987 and 1986, the company was contingently liable for $23 and $22 million, respectively, for obligations of affiliated companies and others. In addition, the company had contingent liabilities at both dates resulting from throughput agreements with pipeline and processing companies in which it holds stock interests. Under these agreements, Phillips may be required to provide any such company with additional funds through advances against future charges for the shipping or processing of petroleum liquids, natural gas and refined products.

While it is not possible at this time to establish the ultimate amount of liability with respect to contingent liabilities, including those related to legal proceedings, the company is of the opinion that the aggregate amount of any such liabilities for which provision has not been made will not have a material adverse effect on its financial position.

Note 11—Incentive Compensation Plans

The company has two incentive compensation plans that provide awards to key employees. These plans are the Incentive Compensation Plan and the 1986 Stock Plan. In anticipation of awards that may become payable under the plans, provisions of $5, $10 and $14 million have been charged against earnings in 1987, 1986 and 1985, respectively.

The 1986 Stock Plan, which includes the Stock Option Plan and the Strategic Incentive Plan, is in effect for the five-year period beginning January 1, 1986, through December 31, 1990. The maximum number of shares of the company's common stock that may be used to satisfy the 1986 Stock Plan's obligations for the five-year period, subject to stock splits, stock dividends and other similar actions, is approximately eight million shares.

Options granted under the provisions of the Stock Option Plan permit the purchase of shares of the company's common stock at exercise prices equivalent to the average market price of the stock on the date the options were granted. The options have a term of 10 years and become exercisable in increments up to 25 percent on each anniversary date following the date of grant. During 1987, options for 2,442,847 shares were granted and options for 7,575 shares were forfeited. At December 31, 1987, 2,435,272 shares were under option at exercise prices ranging from $12.63 to $16.63; none of which were exercisable. The company did not incur any compensation expense in granting the options.

Note 12—Retirement Income Plans

The company has defined benefit retirement plans covering substantially all employees. Effective September 1, 1986, the company's principal retirement plan was restructured into two separate plans—one covering active employees and the other covering retirees. Annuity contracts, purchased from an insurance company, settled the company's obligation for retiree benefits, as well as those accrued by active employees as of September 1, 1986.

The active plan is noncontributory and benefits are based on an employee's years of service and average earnings for the three highest consecutive calendar years of compensation during the 10 years immediately preceding retirement. Plans of subsidiaries that have not adopted the company's principal retirement plan are generally noncontributory with benefit formulas based on employee earnings, credited service or both. The company's funding policy for U.S. plans is to contribute the minimum required by the Employee Retirement Income Security Act of 1974. The company also sponsors nonqualified supplementary retirement plans for senior management and nonemployee directors. Plans for the majority of foreign employees are fully insured, and premiums are expensed when paid. Pension cost (income) was as follows:

	Millions of Dollars		
	1987	1986	1985
U.S. Plans			
Service cost—benefits earned during the period	**$ 17**	23	28
Interest cost on projected benefit obligation	**16**	64	101
Return on assets			
Actual	**(10)**	(158)	(300)
Deferred gains (losses)	**(5)**	64	149
Amortization of			
Net asset	**(7)**	(18)	(31)
Unrecognized net (gains) losses	**—**	(7)	—
Net pension cost (income) for U.S. plans	**11**	(32)	(53)
Foreign Plans	**7**	8	8
Net pension cost (income)	**$ 18**	(24)	(45)
Assumptions Used for U.S. Plans—Weighted Average at December 31			
Rate of increase in compensation levels	**6¼%**	6¼	7
Discount rate	**10**	9¼	9¼
Long-term rate of return on assets	**11**	9¼	9¼

In determining net pension cost, the company has elected to amortize unrecognized net gains and losses on a straight-line basis over 10 years. The $42 million increase in pension cost for 1987 is primarily a result of the restructuring on September 1, 1986, partially offset by a lower service cost due to 1986 work force reductions. The restructuring increased 1986 pension cost $22 million over 1985.

All the company's funded U.S. plans have assets in excess of the accumulated benefit obligation. Assets include a participation right to an annuity contract, real estate, commingled funds and a separate account with an insurance company. The following table presents the funded status of the plans and a reconciliation with accrued pension cost and deferred gain on reversion at December 31.

	Millions of Dollars	
	1987	1986
Plan assets at fair value	**$ 171**	158
Actuarial present value of benefit obligations		
Vested benefits	**41**	47
Nonvested benefits	**1**	1
Accumulated benefit obligation	**42**	48
Effect of projected future salary increases	**138**	105
Projected benefit obligation	**180**	153
Excess assets (obligation)	**(9)**	5
Unrecognized net gains	**(12)**	(12)
Unrecognized net asset	**(89)**	(96)
Accrued pension cost and deferred gain on reversion	**$(110)**	(103)

Accrued pension cost and deferred gain on reversion is reflected in the balance sheet as follows:

	Millions of Dollars	
	1987	1986
Deferred charges	**$ 6**	3
Other accruals	**(18)**	(2)
Other liabilities and deferred credits	**(98)**	(104)
	$(110)	(103)

Note 13—Foreign Currency Gains and Losses

After-tax transaction gains and losses decreased earnings $42 and $9 million in 1987 and 1985, respectively, and increased earnings $87 million in 1986.

Note 14—Taxes

Taxes charged to income were as follows:

	Millions of Dollars		
	1987	1986	1985
Taxes Other Than Income Taxes			
Property	**$ 76**	78	81
Crude oil excise	**—**	13	127
Production	**65**	57	115
Payroll	**44**	41	55
Environmental	**17**	—	—
Other	**15**	21	34
	217	210	412
Income Taxes			
Federal			
Current	**23**	193	(36)
Deferred	**(142)**	(174)	76
Foreign			
Current	**181**	429	964
Deferred	**151**	(19)	189
State and local (current)	**18**	17	20
	231	446	1,213
Total taxes charged to income	**$ 448**	656	1,625

Federal income taxes of $193 million were paid in 1985 related to the purchase of Aminoil Inc.

Deferred income taxes related to timing differences were:

	Millions of Dollars		
	1987	1986	1985
Depreciation	**$138**	116	407
Intangible drilling and certain other costs	**(29)**	(47)	109
Dismantlement provision	**(16)**	(16)	(66)
Leasehold impairment	**(6)**	(37)	(18)
Asset dispositions	**3**	(95)	(197)
Contingencies and accruals	**(54)**	(17)	(20)
Employee benefit plans	**(6)**	(82)	16
Interest rate swap agreements	**(20)**	—	—
Inventories	**12**	(5)	14
Special separation and reorganization programs	**(12)**	(10)	(9)
Other	**(1)**	—	29
	$ 9	(193)	265

Deferred taxes have not been provided for the company's equity in undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds. At December 31, 1987, 1986 and 1985, the aggregate of these funds was $298, $311 and $354 million, respectively, excluding amounts which if remitted would be expected to result in little or no tax because of available tax credits and other deductions.

The amounts of U.S. and outside U.S. income before income taxes and a reconciliation of tax at the federal statutory rate with the provision for income taxes follow:

	Millions of Dollars			Percent of Pretax Income		
	1987	1986	1985	1987	1986	1985
Income (loss) before income taxes United States	$(305)	(78)	287	(114.7)%	(11.6)	17.6
Outside United States	571	752	1,344	214.7	111.6	82.4
	$ 266	674	1,631	100.0%	100.0	100.0
Federal statutory income tax	$ 106	310	750	40.0%	46.0	46.0
Foreign taxes in excess of federal statutory rate	144	143	547	54.1	21.2	33.5
Income taxed at capital gain rate	—	(17)	(90)	—	(2.5)	(5.5)
Possession tax credit	(19)	(13)	(12)	(7.1)	(1.9)	(.7)
Acquisition adjustments	(16)	—	—	(6.0)	—	—
State income taxes—net of federal benefit	11	9	11	4.1	1.4	.7
Amortization of excess cost	6	7	7	2.2	1.0	.4
Other	(1)	7	—	(.4)	1.0	—
	$ 231	446	1,213	86.9%	66.2	74.4

Excise taxes collected on the sale of petroleum products and paid to taxing agencies were $206, $168 and $166 million for the years ended December 31, 1987, 1986 and 1985, respectively. These taxes are excluded from reported revenues.

All deficiencies related to the examination of the company's U.S. income tax returns by the Internal Revenue Service have been settled through 1974. The company is of the opinion that any unsettled deficiencies for subsequent years will not have a material effect on the financial position of the company.

The company has not adopted FASB Statement No. 96, "Accounting for Income Taxes," which was issued in December 1987. See Management's Discussion and Analysis for a discussion of the Statement.

Note 15—Other Financial Information

	Millions of Dollars Except Per Share Amounts		
	1987	1986	1985
Interest			
Incurred	$ 788	741	897
Capitalized	(59)	(56)	(51)
Expensed	$ 729	685	846
Maintenance and repairs— expensed*	$ 499	372	390
Research and development expenditures—expensed	$ 94	89	107
Dividends declared and paid per share			
On common stock			
Cash	$ .60	.70	.95
Preferred stock	—	—	1.36
On preferred stock—cash	1.73	2.02	1.04

**Includes expenses of $150, $32 and $2 million in 1987, 1986 and 1985, respectively, to elevate six offshore platforms in Norway.*

Note 16—Segment and Geographic Information

The company is involved primarily in Petroleum and Chemicals operations. Petroleum operations are fully integrated and involve the exploration, production, processing, transportation and refining of crude oil and natural gas, together with the subsequent transportation and marketing of products derived therefrom. This segment also provides feedstock for the production of petrochemicals. Chemicals operations involve the manufacture and marketing of a broad range of petroleum-based chemical products. Minerals and various other operations are included in Other.

Sales and other operating revenues to outside customers and sales within Phillips by business segment and by geographic area are at market value. Operating profit excludes general corporate revenue and expense, interest, unusual items and income taxes. The company's share of earnings of affiliated companies has been included with the segment and geographic area in which the affiliate operates. Intersegment and intergeographic sales are eliminated in determining consolidated revenue. Corporate assets are principally cash.

Analysis of Results by Business Segment

Years Ended December 31	Millions of Dollars		
	1987	1986	1985
Sales and Other Operating Revenues to Outside Customers			
Petroleum			
Exploration and production	$ 1,187	1,284	2,110
Gas and gas liquids	767	811	1,122
Refining, marketing and transportation	6,809	5,955	10,084
	8,763	8,050	13,316
Chemicals	1,928	1,698	2,266
Other	30	40	94
	$10,721	9,788	15,676
Sales within Phillips			
Petroleum			
Exploration and production	$ 1,111	1,108	2,131
Gas and gas liquids	611	671	1,115
Refining, marketing and transportation	477	461	638
Eliminations (intrasegment)	(1,743)	(1,796)	(3,262)
	456	444	622
Chemicals	161	161	241
Other	19	26	33
	$ 636	631	896
Summary of Net Income			
Operating Profit			
Petroleum			
Exploration and production	$ 381	255	1,879
Gas and gas liquids	39	(8)	291
Refining, marketing and transportation	201	458	342
	621	705	2,512
Chemicals	482	299	219
Other	(12)	(17)	(14)
Total operating profit	1,091	987	2,717
Other revenues	131	151	81
Nonoperating items	(1,187)	(910)	(2,380)
	$ 35	228	418
Total Assets			
Petroleum			
Exploration and production	$ 5,192	5,601	6,690
Gas and gas liquids	1,236	1,289	1,355
Refining, marketing and transportation	2,643	2,500	2,774
	9,071	9,390	10,819
Chemicals	1,165	1,053	1,315
Corporate and Other	1,875	1,960	1,918
	$12,111	12,403	14,052

Years Ended December 31	Millions of Dollars		
	1987	1986	1985
Depreciation, Depletion, Amortization and Retirements			
Petroleum			
Exploration and production	$ 600	781	716
Gas and gas liquids	113	110	101
Refining, marketing and transportation	113	108	105
	826	999	922
Chemicals	63	66	72
Corporate and Other	33	31	57
	$ 922	1,096	1,051
Capital Expenditures— Properties, Plants and Equipment			
Petroleum			
Exploration and production	$ 401	349	680
Gas and gas liquids	46	89	136
Refining, marketing and transportation	131	75	95
	578	513	911
Chemicals	78	46	45
Corporate and Other	94	101	132
	$ 750	660	1,088

Analysis of Results by Geographic Area

Years Ended December 31	Millions of Dollars		
	1987	1986	1985
Sales and Other Operating Revenues to Outside Customers			
United States	$ 9,106	7,955	12,551
Norway	520	716	1,100
United Kingdom	614	651	1,161
Africa	57	43	141
Other areas	424	423	723
	$10,721	9,788	15,676
Sales within Phillips			
United States	$ 131	102	101
Norway	170	109	226
United Kingdom	4	6	10
Africa	181	161	288
Other areas	36	32	32
	$ 522	410	657
Operating Profit			
United States	$ 599	516	1,378
Norway	215	387	950
United Kingdom	90	57	152
Africa	122	(38)	195
Other areas	65	65	42
	$ 1,091	987	2,717

Years Ended December 31	Millions of Dollars		
	1987	1986	1985
Total Assets			
United States	$ 8,306	8,619	9,804
Norway	1,143	1,071	1,168
United Kingdom	471	459	636
Africa	246	239	385
Other areas	367	353	498
Corporate	1,578	1,662	1,561
	$12,111	12,403	14,052
Export Sales	$ 424	415	509

Selected Quarterly Financial Data

	Millions of Dollars			
	Sales and Other Operating Revenues*	Income before Income Taxes*	Net Income (Loss)	Net Income (Loss) Per Share of Common Stock
1987				
First	$2,491	32	(32)	(.16)
Second	2,609	30	3	(.01)
Third	2,764	61	31	.11
Fourth	2,857	143	33	.12
1986				
First	3,072	326	96	.39
Second	2,301	53	8	.01
Third	2,117	240	113	.47
Fourth	2,298	55	11	.02

**Restated—see Note 1 of the Notes to Financial Statements.*

Unusual items in 1987 decreased income before income taxes $43 million in the fourth quarter. Due to unusual items in 1986, income before income taxes has been increased by $138 and $306 million in the first and third quarters, respectively, and decreased by $83 and $6 million in the second and fourth quarters, respectively.

Oil and Gas Operations
Statistics

Net Production	1987	1986	1985
	Thousands of Barrels Daily		
Crude Oil			
United States	113	124	154
Norway	46	52	63
United Kingdom	22	23	24
Africa	25	29	32
Other areas	12	10	8
	218	238	281
Natural Gas Liquids			
United States Plant			
Production from leasehold gas	29	36	31
Production from purchased gas	145	156	161
	174	192	192
Norway production from leasehold gas	8	10	12
	182	202	204
Natural Gas	Millions of Cubic Feet Daily		
United States	772	820	876
Norway	241	217	327
United Kingdom	43	54	55
Other areas	30	29	48
	1,086	1,120	1,306

Average Sales Prices	1987	1986	1985
Crude Oil—Per Barrel			
United States	$16.35	13.83	24.56
Norway	18.26	14.98	27.55
United Kingdom	18.38	15.09	27.80
Africa	18.10	14.04	27.72
Other areas	13.10	10.02	15.19
Worldwide	17.02	14.09	25.65
Natural Gas Liquids—Per Barrel			
United States plant*	8.11	7.89	13.13
Norway	8.50	14.11	15.03
Natural Gas—Per Thousand Cubic Feet			
United States lease	1.45	1.64	2.06
United States lease and natural gas liquids plant**	1.48	1.70	2.23
Norway	3.10	4.72	4.30
United Kingdom	1.63	1.37	1.16
Other areas	1.27	1.38	2.35
Worldwide	1.88	2.30	2.65

**Unfractionated NGL stream sold to downstream operations. Average sales price of fractionated NGL production sold by downstream operations was $11.14, $10.94 and $16.52 per barrel for 1987, 1986 and 1985, respectively.*

***Excludes sales of liquefied natural gas from Kenai, Alaska.*

Average Production (Lifting) Costs*— Per Equivalent Barrel of Oil	1987	1986	1985
United States	$ 4.86	4.88	7.11
Norway	10.69	7.07	4.82
United Kingdom	2.18	1.88	2.06
Africa	4.56	5.87	5.57
Other areas	4.53	4.12	4.47

Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13 and $127 million in 1986 and 1985, respectively, and expenses to elevate six offshore platforms in Norway of $150, $32 and $2 million in 1987, 1986 and 1985, respectively. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.

Acreage at December 31, 1987	Thousands of Acres Gross	Net
Developed		
United States	2,462	1,649
Norway	95	23
United Kingdom	13	3
Africa	104	29
Other areas	395	111
	3,069	1,815
Undeveloped		
United States	5,234	3,643
Norway	1,011	276
United Kingdom	1,421	511
Africa	28,245	7,661
Asia	3,169	1,411
Canada	1,624	440
Other areas	3,611	876
	44,315	14,818

Net Wells Completed*	Productive 1987	Productive 1986	Productive 1985	Dry 1987	Dry 1986	Dry 1985
Exploratory						
United States	17	10	16	14	22	43
Norway	—	—	—	—	—	—
United Kingdom	—	—	—	—	1	2
Africa	—	—	—	—	1	2
Other areas	6	2	—	8	3	1
	23	12	16	22	27	48
Development						
United States	117	81	208	11	11	18
Norway	—	—	1	—	—	—
United Kingdom	—	1	—	—	—	—
Africa	1	—	—	—	—	—
Other areas	3	6	5	1	1	2
	121	88	214	12	12	20

Excludes farmout arrangements.

Wells at Year-End 1987	In Progress* Gross	In Progress* Net	Productive** Oil Gross	Productive** Oil Net	Productive** Gas Gross	Productive** Gas Net
United States	392	72	33,085	7,424	5,518	2,715
Norway	10	4	94	33	34	10
United Kingdom	28	7	12	4	29	5
Africa	5	1	190	49	10	2
Other areas	21	6	1,016	355	324	94
	456	90	34,397	7,865	5,915	2,826

Includes wells which have been temporarily suspended.
**Includes 1,309 gross and 501 net multiple completion wells.*

Capitalized Costs

At December 31	Millions of Dollars 1987	1986
Proved properties	$8,186	7,989
Unproved properties	700	809
	8,886	8,798
Accumulated depreciation, depletion and amortization	4,340	3,776
	$4,546	5,022

- Capitalized costs include the cost of equipment and facilities that support only oil and gas producing activities. Not included are investments in natural gas liquids extraction plants and related systems, as well as downstream manufacturing, distribution and marketing facilities.
- Proved properties include capitalized costs for oil and gas leaseholds holding proved reserves, wells and related equipment and facilities (including uncompleted well costs) and support equipment.
- Unproved properties include capitalized costs for oil and gas leaseholds under exploration, including those where petroleum liquids and natural gas were found but not in quantities to be considered proved reserves.

Costs Incurred

	Millions of Dollars			
	Acquisition	Exploration	Development	Total
1987				
United States	$28	128	143	299
Norway	—	8	87	95
United Kingdom	—	28	17	45
Africa	—	8	8	16
Other areas	7	31	4	42
	$35	203	259	497
1986				
United States	$13	130	166	309
Norway	—	5	87	92
United Kingdom	—	24	5	29
Africa	2	6	9	17
Other areas	1	24	13	38
	$16	189	280	485
1985				
United States	$25	234	348	607
Norway	—	14	107	121
United Kingdom	—	36	3	39
Africa	—	15	19	34
Other areas	2	66	24	92
	$27	365	501	893

- Costs incurred include both capitalized and expensed items.
- Acquisition costs include the costs of acquiring undeveloped oil and gas leaseholds.
- Exploration costs include geological and geophysical expenses, the cost of retaining undeveloped leaseholds, and exploratory drilling costs.
- Development costs include the cost of drilling and equipping development wells and building related production facilities for extracting, treating, gathering and storing petroleum liquids and natural gas.

Proved Reserves Worldwide

Years Ended December 31	Crude Oil					
	Millions of Barrels					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
Developed and Undeveloped						
End of 1984	530	234	37	100	30	931
Revisions of previous estimates	30	53	8	5	11	107
Improved recovery	5	—	—	—	—	5
Extensions and discoveries	6	—	—	—	4	10
Production	(56)	(23)	(9)	(11)	(2)	(101)
Sales of reserves in place	(49)	—	—	—	(2)	(51)
End of 1985	466	264	36	94	41	901
Revisions of previous estimates	(27)	(25)	—	(1)	(9)	(62)
Improved recovery	1	—	—	—	—	1
Purchases of reserves in place	1	—	—	—	—	1
Extensions and discoveries	6	—	86	1	1	94
Production	(44)	(19)	(8)	(11)	(2)	(84)
Sales of reserves in place	(48)	—	(85)	—	—	(133)
End of 1986	355	220	29	83	31	718
Revisions of previous estimates	1	57	6	4	8	76
Improved recovery	4	—	—	—	1	5
Purchases of reserves in place	1	—	—	—	—	1
Extensions and discoveries	13	—	—	3	6	22
Production	(40)	(17)	(7)	(9)	(4)	(77)
Sales of reserves in place	(1)	—	—	—	—	(1)
End of 1987	**333**	**260**	**28**	**81**	**42**	**744**
Developed						
End of 1984	386	176	37	88	27	714
End of 1985	373	194	36	84	36	723
End of 1986	280	176	28	61	30	575
End of 1987	**261**	**188**	**27**	**58**	**36**	**570**

- Proved reserves are those quantities of crude oil, natural gas liquids and natural gas which, upon analysis of geological and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. As additional information becomes available or conditions change, proved reserve estimates must be revised.
- Developed reserves are those portions of proved crude oil, natural gas liquids and natural gas reserves that are recoverable through existing well bores and production equipment and facilities.

- For 1986, extensions and discoveries and sales of reserves in place in the United Kingdom include 85 million barrels of crude oil reserves that were added and sold during the year.
- For 1987, reserves in Other Areas include six million barrels being produced pursuant to an exclusive service contract. In prior years, these were reported as reserves attributable to a long-term supply agreement.

Years Ended December 31	Natural Gas — Billions of Cubic Feet				
	United States	Norway	United Kingdom	Other Areas	Total
Developed and Undeveloped					
End of 1984	3,925	1,634	173	382	6,114
Revisions of previous estimates	(27)	(644)	23	(42)	(690)
Extensions and discoveries	57	—	6	84	147
Production	(322)	(128)	(19)	(18)	(487)
Sales of reserves in place	(53)	—	—	(148)	(201)
End of 1985	3,580	862	183	258	4,883
Revisions of previous estimates	(93)	542	(66)	29	412
Extensions and discoveries	67	—	357	5	429
Production	(283)	(91)	(17)	(10)	(401)
Sales of reserves in place	(39)	—	(140)	—	(179)
End of 1986	3,232	1,313	317	282	5,144
Revisions of previous estimates	267	132	(33)	5	371
Extensions and discoveries	159	—	7	19	185
Production	(281)	(97)	(16)	(13)	(407)
Sales of reserves in place	(8)	—	—	—	(8)
End of 1987	**3,369**	**1,348**	**275**	**293**	**5,285**
Developed					
End of 1984	3,596	1,634	173	331	5,734
End of 1985	3,292	825	177	209	4,503
End of 1986	3,020	1,252	74	202	4,548
End of 1987	**3,091**	**1,286**	**68**	**221**	**4,666**

- The 1985 revisions of previous estimates in Norway reserves were the result of the gas-reinjection program to reduce the rate of subsidence in the Ekofisk field in the Norwegian North Sea. The 1986 revisions are the result of reducing the gas-reinjection program.
- For 1986, extensions and discoveries and sales of reserves in place in the United Kingdom include 140 billion cubic feet of natural gas reserves that were added and sold during the year.
- Natural gas reserves are computed at 14.65 pounds per square inch absolute and 60° Fahrenheit.

Years Ended December 31	Natural Gas Liquids — Millions of Barrels			
	United States	Norway	Other Areas	Total
Developed and Undeveloped				
End of 1984	129	49	1	179
Revisions of previous estimates	(8)	7	—	(1)
Extensions and discoveries	1	—	—	1
Production	(12)	(5)	—	(17)
End of 1985	110	51	1	162
Revisions of previous estimates	43	(5)	—	38
Extensions and discoveries	2	—	—	2
Production	(14)	(3)	—	(17)
End of 1986	141	43	1	185
Revisions of previous estimates	(6)	(1)	1	(6)
Production	(11)	(3)	—	(14)
End of 1987	**124**	**39**	**2**	**165**
Developed				
End of 1984	129	49	1	179
End of 1985	109	51	1	161
End of 1986	141	41	1	183
End of 1987	**123**	**37**	**2**	**162**

Results of Operations

	Millions of Dollars					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
1987						
Sales	$ 521	322	159	19	67	1,088
Transfers	597	291	15	152	5	1,060
Total revenues	1,118	613	174	171	72	2,148
Production (lifting) costs	419	367	23	43	28	880
Exploration expenses	294	5	22	5	35	361
Depreciation, depletion, amortization and retirements	445	49	53	14	17	578
	(40)	192	76	109	(8)	329
Provision for income taxes	(15)	116	27	82	1	211
Results of operations for producing activities	$ (25)	76	49	27	(9)	118
1986						
Sales	$ 571	414	130	3	49	1,167
Transfers	582	317	22	139	4	1,064
Total revenues	1,153	731	152	142	53	2,231
Production (lifting) costs	460	256	22	62	23	823
Exploration expenses*	318	48	26	44	20	456
Depreciation, depletion, amortization and retirements*	515	63	77	91	11	757
	(140)	364	27	(55)	(1)	195
Provision for income taxes	(72)	279	11	53	—	271
Results of operations for producing activities	$ (68)	85	16	(108)	(1)	(76)
1985						
Sales	$ 977	593	261	26	88	1,945
Transfers	1,112	634	—	301	—	2,047
Total revenues	2,089	1,227	261	327	88	3,992
Production (lifting) costs	772	230	25	65	27	1,119
Exploration expenses*	319	22	36	22	53	452
Depreciation, depletion, amortization and retirements*	421	128	73	57	15	694
	577	847	127	183	(7)	1,727
Provision for income taxes	260	672	70	201	9	1,212
Results of operations for producing activities	$ 317	175	57	(18)	(16)	515

**In 1987, dry hole and leasehold impairment expenses were reclassified from depreciation, depletion, amortization and retirements to exploration expenses.*

- Sales exclude revenues received from operation of natural gas liquids extraction plants and related gas systems. Transfers are valued at prices which approximate market prices.
- Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13 and $127 million in 1986 and 1985, respectively, and expenses to elevate six offshore platforms in Norway of $150, $32 and $2 million in 1987, 1986 and 1985, respectively. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.
- Exploration expenses include dry hole, leasehold impairment, geological and geophysical expenses and the cost of retaining undeveloped leaseholds.
- The provision for income taxes is computed by adjusting each country's income before income taxes for permanent differences related to the oil and gas producing activities that are reflected in the company's consolidated income tax expense for the period and then multiplying the result by the country's statutory tax rate.
- Results of operations should not be equated to net income since no deduction has been made for such costs and expenses as distribution, selling, administrative and interest.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities

	Millions of Dollars					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
1987						
Future cash inflows	$ 9,964	8,599	1,031	1,401	851	21,846
Less:						
Future production costs	4,166	3,342	164	210	394	8,276
Future development costs	1,020	386	107	97	213	1,823
Future income tax provisions	1,129	3,466	350	870	—	5,815
Future net cash flows	3,649	1,405	410	224	244	5,932
10% annual discount	1,700	721	124	91	155	2,791
Discounted future net cash flows	$ 1,949	684	286	133	89	3,141
1986						
Future cash inflows	$ 9,137	9,634	969	1,437	778	21,955
Less:						
Future production costs	3,136	3,446	263	252	272	7,369
Future development costs	996	412	137	62	177	1,784
Future income tax provisions	1,255	4,371	265	960	53	6,904
Future net cash flows	3,750	1,405	304	163	276	5,898
10% annual discount	1,707	680	73	75	169	2,704
Discounted future net cash flows	$ 2,043	725	231	88	107	3,194
1985						
Future cash inflows	$18,492	11,142	1,330	2,622	1,463	35,049
Less:						
Future production costs	6,642	1,982	136	341	576	9,677
Future development costs	1,513	803	85	74	174	2,649
Future income tax provisions	3,825	6,509	846	1,945	263	13,388
Future net cash flows	6,512	1,848	263	262	450	9,335
10% annual discount	3,289	898	70	93	262	4,612
Discounted future net cash flows	$ 3,223	950	193	169	188	4,723

- Future net cash flows is computed using year-end prices and costs and appropriate statutory tax rates that relate to existing proved oil and gas reserves in which the company has mineral interests.

Sources of change in the standardized measure of discounted future net cash flows are as follows:

	Millions of Dollars		
	1987	1986	1985
Revenues less production costs for the year	**$(1,268)**	(1,408)	(2,873)
Net change in prices and production costs for the year	**(574)**	(5,313)	757
Extensions, discoveries and improved recovery less estimated future costs	**217**	1,019	258
Development costs for the year	**259**	280	501
Sales of reserves in place less estimated future costs	**(4)**	(972)	(554)
Revisions of previous quantity estimates and other	**114**	156	(585)
Accretion of discount	**629**	1,188	1,307
Net change in income taxes	**574**	3,521	311
	$ (53)	(1,529)	(878)

- The net change in prices and production costs is the beginning of the year reserve quantities multiplied by the net annual change in the per unit sales price and production cost.
- Purchases and sales of reserves in place, and extensions, discoveries and improved recovery are production forecasts of the applicable reserve quantities for the year multiplied by the end of the year sales price, less future estimated development and production costs, discounted at 10 percent.
- The accretion of discount is 10 percent of prior year's discounted future cash inflows less future production and development costs.
- The net change in income taxes is the annual change in the discounted future income tax provisions.

Five-Year Financial Review

PHILLIPS PETROLEUM COMPANY

	Millions of Dollars Except as Indicated				
	1987	1986*	1985*	1984*	1983*
Selected Income Data					
Sales and other operating revenues	$10,721	9,788	15,676	15,537	15,249
Net income	35	228	418	810	721
Selected Balance Sheet Data					
Current assets	2,885	2,802	3,150	4,611	2,903
Properties, plants and equipment (net)	8,772	9,186	10,365	11,773	9,549
Total assets	12,111	12,403	14,052	16,965	13,094
Current liabilities	2,402	2,234	3,114	5,352	2,881
Long-term debt	5,419	5,758	6,548	2,840	2,242
Deferred income taxes	1,705	1,685	1,673	1,433	1,210
Redeemable preferred stock	205	270	281	—	—
Common stockholders' equity	1,617	1,724	1,644	6,624	6,149
Selected Statement of Changes in Financial Position Data					
Funds from operations before changes in working capital	1,219	1,287	2,130	2,232	1,993
Capital expenditures					
Exploration and Production	401	349	680	747	706
Gas and Gas Liquids	46	89	136	329	125
Petroleum Products	131	75	95	109	126
Chemicals	78	46	45	77	64
Corporate and Other	94	101	132	125	120
Total	750	660	1,088	1,387	1,141
Purchase of net noncurrent assets of acquired companies	—	—	—	1,998	1,229
Dividends paid					
On common stock	137	159	542	362	337
On preferred stock	19	24	12	—	—
Other Data					
Net income					
As percent of total revenues	.3%	2.3	2.6	5.1	4.7
As percent of average total assets	.3%	1.7	2.7	6.0	5.5
As percent of average common stockholders' equity	2.1%	13.5	14.7	12.7	12.3
Percent of long-term debt to capital	74.8%	74.3	77.3	30.0	26.7
Current ratio	1.2	1.3	1.0	.9	1.0
Per average common share outstanding**					
Net income	$ .06	.89	1.44	1.75	1.57
Cash dividends declared	$ .60	.70	.95	.78	.73
Common stockholders' equity per share**	$ 7.08	7.55	7.24	14.28	13.38
Market price per common share**					
High	$ 18.75	12.75	17.17	18.75	12.96
Low	$ 10.00	8.25	11.00	11.13	9.79
Close	$ 14.00	11.75	12.13	14.92	11.50
Common shares outstanding at year-end (in millions)**	228.4	228.3	227.1	463.9	459.7
Common stockholders at year-end (in thousands)	100.1	109.0	83.3	113.4	119.8
Gross payroll including employee benefits	$ 998	974	1,130	1,164	1,192
Employees at year-end (in thousands)	22.5	21.8	25.3	29.3	28.4

**Restated—see Note 1 of the Notes to Financial Statements.*
***Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Five-Year Operating Review

Exploration and Production	1987	1986	1985	1984	1983
	Thousands of Barrels Daily				
Net Crude Oil Production					
United States	113	124	154	136	127
Norway	46	52	63	72	81
United Kingdom	22	23	24	24	5
Africa	25	29	32	28	27
Canada	5	4	4	4	4
Southeast Asia	2	1	—	3	3
Latin America	5	5	4	1	—
	218	238	281	268	247
Net Natural Gas Liquids Production					
Norway	8	10	12	12	14
Gas and Gas Liquids*	174	192	192	180	161
	182	202	204	192	175

**See Gas and Gas Liquids for amount from Phillips U.S. leasehold gas.*

Net Natural Gas Production	Millions of Cubic Feet Daily				
United States	772	820	876	843	799
Norway	241	217	327	364	381
United Kingdom	43	54	55	58	62
Canada	30	29	31	19	24
Other Europe	—	—	17	4	—
	1,086	1,120	1,306	1,288	1,266

Net Oil and Gas Acreage	Millions of Acres				
United States	5	6	7	9	8
Europe	2	1	1	2	2
Africa	8	2	1	2	2
Canada	1	3	4	4	2
Southeast Asia	1	1	2	6	7
Latin America	—	—	—	1	2
Australia and New Zealand	—	—	—	—	1
	17	13	15	24	24

Oil and Gas Wells	Net Wells				
United States					
Oil	7,424	7,861	9,077	9,207	8,210
Gas and condensate	2,715	2,749	2,805	2,744	2,573
Outside United States					
All wells	552	576	542	561	473
	10,691	11,186	12,424	12,512	11,256

Well Completions					
United States					
Exploratory	31	32	59	72	51
Development	128	92	226	269	203
Outside United States					
Exploratory	14	7	5	5	7
Development	5	8	8	27	7
	178	139	298	373	268

Gas and Gas Liquids (United States)	1987	1986	1985	1984	1983
	Millions of Cubic Feet Daily				
Natural Gas Purchases					
From unaffiliated entities	1,602	1,531	1,542	1,367	1,222
From consolidated operations	357	395	378	396	397
	1,959	1,926	1,920	1,763	1,619
Natural Gas Processed	1,910	2,041	2,160	1,858	1,715
Natural Gas Sales					
Natural gas	1,044	1,009	1,044	895	756
Liquefied natural gas	93	96	101	101	101
	1,137	1,105	1,145	996	857
Net Natural Gas Liquids Plant Production*	Thousands of Barrels Daily				
From leasehold gas	29	36	31	33	27
From purchased gas	145	156	161	147	134
	174	192	192	180	161

**See Exploration and Production for total company production.*

Petroleum Products

Refinery Operations					
United States					
Crude oil capacity	305	300	300	295	295
Crude oil runs	302	301	292	288	260
Natural gas liquids processing capacity	223	223	223	218	228
Natural gas liquids processed	195	201	195	193	187

Petroleum Products Sold					
United States					
Automotive gasoline	256	243	239	218	212
Aviation fuels	32	31	31	26	23
Distillates	98	93	91	82	81
Liquefied petroleum gas	90	99	108	95	98
Other products	37	47	59	35	38
	513	513	528	456	452
Outside United States	42	41	47	51	53
	555	554	575	507	505
Marketing Outlets (in thousands)	12	12	12	11	12

Chemicals	Millions of Pounds				
Ethylene sales	903	803	812	481	539
Polyethylene sales	1,606	1,410	1,508	1,358	1,254

Board of Directors and Principal Officers
As of March 1, 1988

Directors

George B. Beitzel, 59, Retired senior vice president and retired director of International Business Machines Corporation; Purchase, N.Y. Elected to Phillips board 1980. Also a director of Bankers Trust New York Corporation and its subsidiary, Bankers Trust Company; FlightSafety International, Inc.; Rohm and Haas Company; Roadway Services, Inc.; and a member of the advisory board of International Business Machines. (3), (4)

Glenn A. Cox, 58, President and Chief Operating Officer. Elected to Phillips board 1982. Also a director of BancOklahoma Corp. (1)

James B. Edwards, 60, President of the Medical University of South Carolina, former U.S. Secretary of Energy and former Governor of South Carolina; Charleston, S.C. Elected to Phillips board 1983. Also a director of J.P. Stevens & Co., Inc.; The South Carolina National Bank; Encyclopaedia Britannica, Inc.; Brendle's, Inc.; SCANA Corporation; Chemical Waste Management, Inc.; and Imo Delaval Inc. (3), (4)

Robert F. Froehlke, 65, President and Chief Executive Officer and director IDS Mutual Fund Group; Minneapolis, Minn. Elected to Phillips board 1984. Also a director of Square D Company and Public Oversight Board of the American Institute of Certified Public Accountants. Also chairman of the Institute for Defense Analysis. (2), (5)

E. Douglas Kenna, 63, Partner of G.L. Ohrstrom & Company, a private investment group; Palm Beach, Fla. Elected to Phillips board 1977. Also a director of Burnley Corporation, Carlisle Corporation and Fleet/Norstar Financial Group. (1), (2), (4)

Melvin R. Laird, 65, Senior Counsellor for National and International Affairs for The Reader's Digest Association, Inc.; Washington, D.C. Elected to Phillips board 1976. Former nine-term U.S. Congressman, Secretary of Defense and Presidential Counsellor. Also a director of Northwest Airlines, Inc.; Commercial Credit Company; Metropolitan Life Insurance Company; Science Applications International Corporation; Communications Satellite Corporation; Martin Marietta Corporation; IDS Mutual Fund Group; and Public Oversight Board of the American Institute of Certified Public Accountants. (4), (5)

*__Carol C. Laise__, 70, Former Director General of the U.S. Foreign Service in the State Department and former U.S. Ambassador to Nepal; Washington, D.C. Elected to Phillips board 1979. Also a director of the American Security Bank. (2), (5)

David B. Meeker, 62, Former Chairman of the Board of Directors of Hobart Corporation, a manufacturer of food equipment and home appliances; Troy, Ohio. Elected to Phillips board 1976. Also a director of Armco Inc.; Bank One, Dayton, N.A.; Dayton Power and Light Company; J.C. Penney Company, Inc.; Square D Company; and Sterling Drug Inc. (1), (3), (4)

Leonard M. Rickards, 60, Executive Vice President. Elected to Phillips board 1987.

C.J. Silas, 55, Chairman of the Board of Directors and Chief Executive Officer. Elected to Phillips board 1982. Also a director of The First National Bank and Trust Company of Tulsa. (1)

Robert G. Wallace, 61, Executive Vice President. Elected to Phillips board 1982. Also a director of UBT Bancorp, Inc., and its subsidiary, Union Bank and Trust Company; CBI Industries, Inc.; and Valmont Industries, Inc.

W. Clarke Wescoe, 67, Retired Chairman of the Board of Directors of Sterling Drug Inc., a diversified pharmaceutical company; Minneapolis, Minn. Elected to Phillips board 1963. Also a director of The New York Stock Exchange and an advisory director of Irving Bank Corporation and its subsidiary, Irving Trust Company. (2), (3)

Dolores D. Wharton, 60, President of The Fund for Corporate Initiatives, Inc., a nonprofit organization devoted to strengthening the role of minorities and women in the corporate world through professional development and upward mobility programs for younger executives; New York, N.Y. Elected to Phillips board 1976. Also a director of Gannett Co., Inc.; Kellogg Company; and Golub Corporation. (3), (5)

Francis M. Wheat, 67, Advisory Partner in the law firm of Gibson, Dunn & Crutcher, Los Angeles, Calif. Elected to Phillips board 1976. (1), (2), (5)

**Miss Laise retires from the board April 26, 1988.*

(1) Member Executive Committee
(2) Member Audit Committee
(3) Member Compensation Committee
(4) Member Nominating Committee
(5) Member Public Policy Committee

Officers

C.J. Silas, Chairman of the Board of Directors and Chief Executive Officer
Glenn A. Cox, President and Chief Operating Officer
Leonard M. Rickards, Executive Vice President
Robert G. Wallace, Executive Vice President
R.E. Bonnell, Senior Vice President Finance
William G. Paul, Senior Vice President and General Counsel
K.L. Smalley, Senior Vice President
Bill M. Thompson, Senior Vice President

Other Corporate Officers

W. Wayne Allen, Vice President International Exploration and Production
C.L. Bowerman, Vice President Marketing Petroleum Products
J. Thomas Boyd, Vice President Public Affairs
C.F. Cook, Vice President Research and Development
J.W. O'Toole, Vice President and General Tax Officer
Richard I. Robinson, Vice President Refining
Ray G. Steiner, Vice President Supply and Transportation
D.J. Tippeconnic, Vice President Human Resources and Services
John R. VanBuskirk, Vice President Plastics
John Whitmire, Vice President North America Exploration and Production
J. Bryan Whitworth, Vice President Corporate Affairs
Charles L. Wyndham, Vice President Exploration
James A. Kelly, Comptroller
J.J. Mulva, Treasurer
Lewis E. Burnham, General Auditor
G.C. Meese, Secretary
J.M. McKee, Assistant Treasurer
Leonard F. Francis, Assistant General Tax Officer
D.L. Cone, Assistant Secretary
Terry B. Nance, Assistant Secretary

Management and Board of Directors Changes

Changes on the board of directors include the following:

- Leonard M. Rickards, executive vice president, was elected to the board of directors on April 30, 1987.
- Carol C. Laise will retire from the board April 26, having reached the mandatory retirement age for directors of 70.

As part of a continuing reorganization, on Jan. 11, 1988, three vice presidents were elected to strengthen upper management in exploration and production, and a vice president was elected to head the company's growing plastics division.

- W. Wayne Allen, formerly general manager western division, was elected vice president international exploration and production.
- John Whitmire, formerly manager drilling and production, was elected vice president North America exploration and production.
- Charles L. Wyndham, formerly manager exploration, was elected vice president exploration.
- John R. VanBuskirk, formerly general manager plastics division, was elected vice president plastics.

Early in 1988, the company consolidated public affairs and government relations into a new corporate affairs staff.

- J. Bryan Whitworth, formerly vice president government relations, became vice president corporate affairs.
- J. Thomas Boyd, vice president public affairs, will be on special assignment to the chairman until his retirement date May 31, 1988.

Other personnel changes occurring during the year follow:

- W.E. Barr, vice president engineering and procurement, elected to retire July 1, 1987.
- John N. Scott, vice president federal relations, was named president of Incinatrol Inc., a new hazardous waste company formed by subsidiaries of Phillips and Raytheon Corporation.

Stockholder Information

Annual Meeting
Phillips annual meeting of stockholders will be held at 10:00 a.m., April 26, 1988, in the Adams Building, 4th St. and Keeler Ave., Bartlesville, Okla. Notice of the meeting and proxy material are being sent to all stockholders.

Information Requests
The company welcomes your comments about its operations or any aspect of its business. Please write to one of the addresses below, or contact Phillips investor relations office in New York City (212/397-9766) or Bartlesville (918/661-5139).

Questions regarding stockholder records, stock certificates, dividends or the dividend reinvestment plan should be directed to stockholder records in Bartlesville. Please write to the company's Bartlesville address in care of the stockholder records section, or call toll-free, 1-800-356-0066 (in Oklahoma, 1-800-722-0660).

Form 10-K
Copies of the company's annual report on Form 10-K, as filed with the Securities and Exchange Commission, are available, without charge, by writing to Office of the Secretary, Phillips Petroleum Company, Bartlesville, Okla. 74004.

Principal Offices
Bartlesville, Okla. 74004

630 Fifth Avenue
New York, N.Y. 10111

306 S. State Street
Dover, Del. 19901

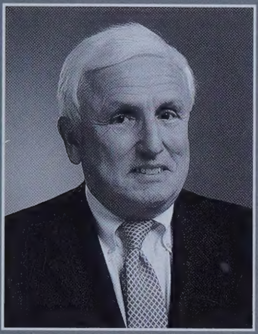
Stock Transfer Offices
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

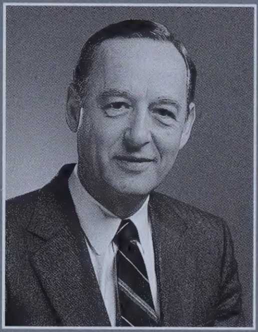
Montreal Trust Company
15 King Street West
Toronto, Ontario
Canada M5H 1B4

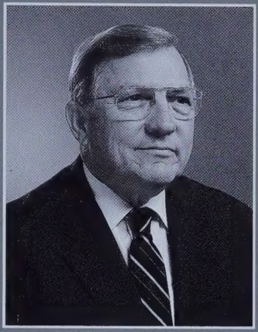
Registrars
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

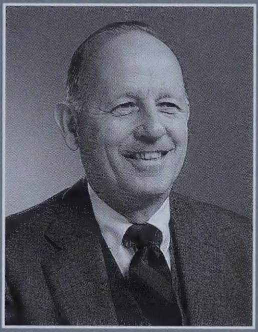
Canada Permanent Trust Company
110 Yonge Street
Toronto, Ontario
Canada M5C 1T4

Board of Directors

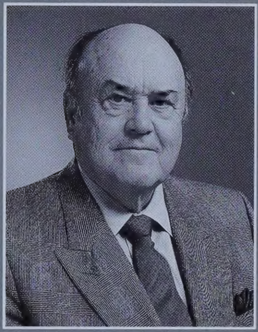

George B. Beitzel

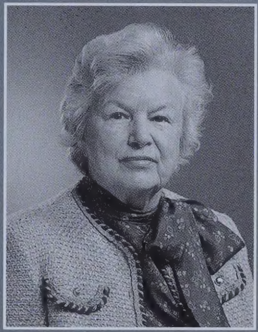

Glenn A. Cox

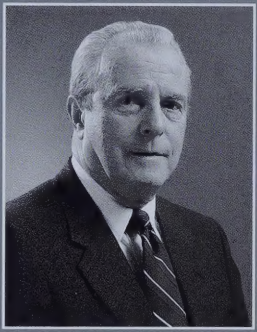

James B. Edwards

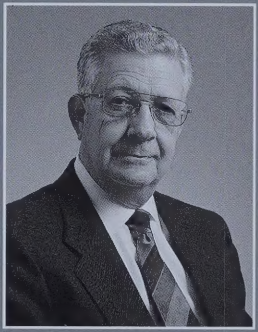

Robert F. Froehlke


E. Douglas Kenna

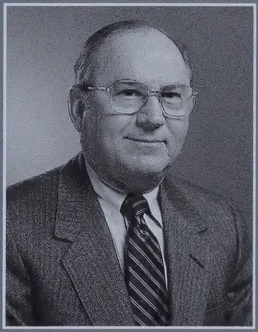

Melvin R. Laird

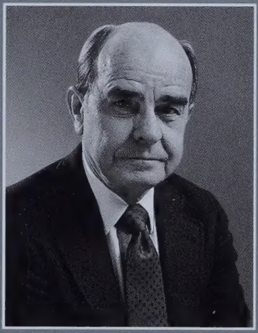

Carol C. Laise

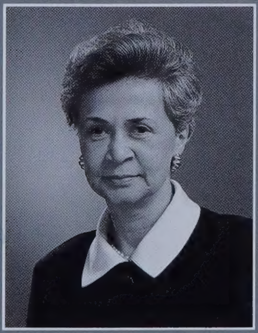

David B. Meeker

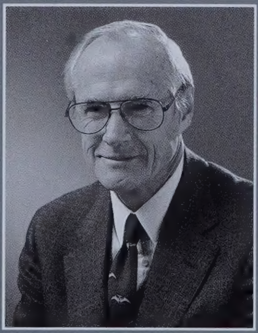

Leonard M. Rickards


C.J. Silas


Robert G. Wallace


W. Clarke Wescoe


Dolores D. Wharton


Francis M. Wheat

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